MISSISSIPPI LAW JOURNAL

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THE SIGNIFICANCE OF THE CLASSIFICATION OF EMPLOYMENT RELATIONSHIPS IN DETERMINING EXPOSURE TO LIABILITY

Deanne M. Mosley[*]

William C. Walter[**]

I. INTRODUCTION

Even the most casual observer can see that the constituency of the American labor force has dramatically changed in recent years.[1] The ever increasing intervention of the federal government into the labor arena has provided incentives for employers to restructure their work forces so that they employ fewer full-time employees and more part-time or temporary employees and/or independent contractors.[2] Some say such restructuring is an effort to circumvent federal labor legislation.[3] Since the majority of labor laws were drafted based upon assumptions of full-time, traditional work arrangements,[4] the hiring of "non-employees," such as independent contractors, may exempt employers from having to comply with federal labor laws.[5] Also, employers may be further motivated to employ fewer "true employees" as a way to minimize liability exposure.[6] Thus, many of today's workers do not fit the traditional employment mold contemplated by the common law and the federal labor statutes.[7]

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[1] *See generally* Scott F. Cooper, *The Expanding Use of the Contingent Work Force in the American Economy: New Opportunities and Dangers for Employers*, 40 EMPL. REL. L.J. 525 (1995) (discussing use of temporary workers); *see also* Jonathan P. Hiatt, *Policy Issues Concerning the Contingent Workforce*, 52 WASH. & LEE L. REV. 739, 741 (1995).

[2] From 1969 to 1993, the number of part-time workers increased from 10.8 million to 20.7 million. *See* Kimberly Hayes, *On the Clock Versus on the Books: The Appropriate Method for Counting Employees Under Title VII, the ADEA and Other Labor Laws*, 44 BUFF. L. REV. 963, 963 n.3 (1996) (citing EMPLOYMENT BENEFIT RESEARCH INST., CHARACTERISTICS OF THE PART-TIME WORK FORCE: ANALYSIS OF THE MARCH 1993 CURRENT POPULATION SURVEY, Special Report & Issues Brief No. 149, at 5 (1993)). In 1990, the Bureau of Labor Statistics report-

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ed that eighteen-percent of the workforce worked fewer than thirty-five hours per week. *Id.* (citing Polly Callaghan & Heidi Hartmann, *Contingent Work: A Chart Book on Part-Time and Temporary Employment*, 1991 ECON. POL'Y INST., at 2).

[3] Rick A. Pacynski, *Legal Challenges in Using Independent Contractors*, 72 MICH. B.J. 671, 671 (1993). Since only "employees" are covered by most of these federal laws, the advantages to employing part-time employees and independent contractors can be far-reaching. *Id.*

It must be noted, however, that in today's environment of low unemployment, workers are arguably more free than ever before to select the employment arrangement that best suits their needs. Part-time employment is certainly the choice by many who wish to maintain flexible work schedules or who simply do not wish to work eight-hour days. Clyde W. Summers, *Contingent Employment in the United States*, 18 COMP. LAB. L. 503, 508 (1997). In addition, the phenomenon of workers failing to fit the model of full-time employment is not a recent development. *Id.* at 503. For instance, dock workers, waitresses, construction workers, and home cleaners have for years worked in "part-time" positions and as independent contractors. *Id.* By doing so, their employers are freed from the strictures of many federal labor statutes. *Id.* The practice of "employee leasing" has also been around for decades, having existed since the 1920s. Edward A. Lenz, *Co-Employment—A Review of Customer Liability Issues in the Staffing Services Industry*, 10 LAB. LAW. 195, 196 (1994).

[4] *See* Hayes, *supra* note 2, at 964.

[5] *See* Knight v. United Farm Bureau Mut. Ins. Co., 950 F.2d 377, 380 (7th Cir. 1991) (stating that to bring claim under Title VII, claimant must first prove existence of employment relationship).

[6] *See generally* Richard A. Booth, *Limited Liability and the Efficient Allocation of Resources*, 89 NW. U.L. REV. 140 (1994); Alan O. Sykes, *The Economics of Vicarious Liability*, 93 YALE L.J. 1231 (1984).

[7] Many of today's employment relationships "vary greatly and often defy easy categorization." Devine v. Stone, Leyton & Gershman, P.C., 100 F.3d 78, 81 (8th Cir. 1996). This subject has enjoyed considerable scholarly attention in recent years. *See, e.g.*, Jonathan G. Axelrod, *Who's the Boss? Employee Leasing and the Joint Employer Relationship*, 3 LAB. LAW. 853 (1987); Craig Becker, *Labor Law Outside the Employment Relation*, 74 TEX. L. REV. 1527 (1996); Martha

II. EMPLOYMENT RELATIONSHIPS AND THIRD PARTY LIABILITY

A. *Classifications of Traditional Employment Relationships*

There are three traditional classifications of employment relationships in which a hiring party employs a secondary party to perform work or service.[8] These relationships are often referred to as (1) principal/agent; (2) master/servant; and (3) independent contractor.[9] The classification of these employment relationships is significant since the hiring party's liability is often predicated upon the status of the employment relationship.[10] It is generally accepted that the principal and the master are subject to liability for the actions of their agents[11] and servants,[12] respectively.[13] However, the hiring

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Chamallas, *Women and Part-Time Work: The Case for Pay Equity and Equal Access*, 64 N.C. L. REV. 709 (1986); H. Lane Dennard, Jr. & Herbert R. Northrup, *Leased Employment: Character, Numbers, and Labor Law Problems*, 28 GA. L. REV. 683 (1994); Gregory L. Hammond, *Flexible Staffing Trends and Legal Issues in the Emerging Workplace*, 10 LAB. LAW. 161 (1994); Jonathan P. Hiatt & Lynn Rhinehart, *The Growing Contingent Work Force: A Challenge for the Future*, 10 LAB. LAW. 143 (1994); Edward A. Lenz, *Co-Employment — A Review of Customer Liability Issues in the Staffing Services Industry*, 10 LAB. LAW. 195 (1994); Summers, *supra* note 3; *Symposium on the Regulatory Future of Contingent Employment*, 52 WASH. & LEE L. REV. 725 (1995).

[8] Richardson v. APAC-Mississippi, Inc., 631 So. 2d 143, 147 (Miss. 1994).

[9] *Id.*

[10] For example, the United States government, pursuant to the Federal Tort Claims Act, waives sovereign immunity for suits based upon the negligent or wrongful act or omission of a government employee, defined as any "person acting on behalf of a federal agency in an official capacity." 28 U.S.C. §§ 1346(b) (1988), 2671 (1990). However, the definitions specifically exclude liability for any contractor with the United States. 28 U.S.C. § 2671 (1990).

[11] Once the agency relationship is established, the principal is liable for the acts of his agent that are within the agent's actual and apparent authority. Forest Oil Corp. v. Tenneco, Inc., 626 F. Supp. 917, 923 (S.D. Miss. 1986). *See* Castle Fabrics, Inc. v. Fortune Furniture Mfrs., Inc., 459 F. Supp. 409, 416 (N.D. Miss. 1978) (stating principal is liable to third parties for agent's actions); Cue Oil Co. v. Fornea Oil Co., 45 So. 2d 597, 599 (Miss. 1950) (holding principal liable for agent's actions that are within agent's actual or apparent authority). Chief Judge Keady remarked that "where a loss is to be suffered through the misconduct of an agent, it should be borne by those who put it in his power to do the wrong, rather than by a stranger." Butler v. Bunge Corp., 329 F. Supp. 47, 56 (N.D. Miss. 1971).

[12] A party may be defined as a "servant" if the party is "employed by a master to perform service in his affairs whose physical conduct in the performance of

party in an independent contractor relationship may be protected from liability arising from the actions of the independent contractor.[14]

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the service is controlled or is subject to the right to control by the master." Selph v. Stricker, 119 So. 2d 351, 354 (Miss. 1960) (quoting Crosby Lumber & Mfg. Co. v. Durham, 179 So. 285, 287 (Miss. 1938)); Texas Co. v. Mills, 156 So. 866, 869 (Miss. 1934). Since the master benefits from the servant's work and since the master has the ability to control his servants, it is the master who has the power to prevent tortious behavior and who will be liable if such occurs. Colvin v. Ellis Constr. Co., 840 F. Supp. 59, 61 (N.D. Miss. 1993). A master is liable for his servant's actions that are committed in furtherance of the master's business. Holliday v. Pizza Inn, Inc., 659 So. 2d 860, 864-65 (Miss. 1995). *See* Canton Cotton Warehouse Co. v. Pool, 28 So. 823, 823 (Miss. 1900) (summarizing a master's liability stemming from his servant). *See also* W. KEETON, PROSSER & KEETON ON TORTS 315 (5th ed. 1984) (stating under doctrine of respondeat superior or vicarious liability "the master becomes responsible for the same act for which the servant is liable."). A master is even liable if the servant, contrary to the instructions of the master, goes beyond his authority while acting in furtherance of the master's business. Jenkins v. Cogan, 119 So. 2d 363, 367-68 (Miss. 1960). Furthermore, if the servant's actions are within the scope of his employment, the master is liable in spite of the actions being in violation of rules, orders, or instructions. *Id.* at 368. However, if the servant deviates from his service so substantially "as to amount to an entire departure therefrom and be for purposes entirely personal to the servant," the master may be relieved from liability. Colotta v. Phillips, 85 So. 2d 574, 577 (Miss. 1956) (quoting 57 C.J.S. *Master and Servant* § 575d). The common law definitions of master and servant are also significant as the Mississippi Legislature has mandated in the Mississippi Employment Security Act that "the relationship of employer and employee shall be determined in accordance with the principles of the common law governing the relation of master and servant." MISS. CODE ANN. § 71-5-11(I)(14) (Rev. 1989).

[13] The principal/agent and the master/servant relationships are closely related, and the law of agency is an "outgrowth and expansion" of the law of master/servant. *Richardson,* 631 So. 2d at 147 n.2 (citing 53 AM. JUR. 2D *Master and Servant* §§ 3-4 (1970)). Generally, there are no essential distinctions which must be drawn between the principal's liability for his agent and the master's liability for his servant. *Id.*

[14] *See* McKee v. Brimmer, 39 F.3d 94, 96 (5th Cir. 1994) (citing W.J. Runyon & Son, Inc. v. Davis, 605 So. 2d 38, 45 (Miss 1992)); *Richardson,* 631 So. 2d at 152; Market Ins. Co. v. United States, 415 F.2d 459, 462 (5th Cir. 1969) (quoting 27 AM. JUR. *Independent Contractor* § 22); Hercules Powder Co. v. Westmoreland, 164 So. 2d 471, 475 (Miss. 1964) (holding hiring party not liable due to determination that independent contractor relationship existed). However, the hiring party is still liable for his own negligence and for any negligence committed by the hiring party against the independent contractor. For example, the hiring party owes a duty to provide a reasonably safe work place or warn the independent contractor of danger, and the hiring party may be liable if this duty is breached. Ingalls

As early as 1885, the Mississippi Supreme Court began promulgating tests and enumerating factors to clarify the distinction between these traditional employment relationships.[15] Recognizing the difficulty in classifying employment relationships, the Mississippi Supreme Court has referred to this area of law as a "twilight zone."[16] Further, since a determination of the relationship's status is typically considered a question of fact,[17] it is often inappropriate for summary judg-

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Shipbuilding Corp. v. McDougald, 228 So. 2d 365, 367 (Miss. 1969). It should be noted that the hiring party may be subjected to liability based upon the negligence of the independent contractor if the independent contractor is performing inherently dangerous activities. Spruill v. Yazoo Valley Oil Mill, Inc., 317 So. 2d 410, 413 (Miss. 1975) (quoting Corban v. Skelly Oil Co., 256 F.2d 775, 780 (5th Cir. 1958)). This liability is predicated upon the belief that the hiring party cannot delegate the duty to see that reasonable precautions are taken when inherently dangerous work is being performed. *Spruill*, 317 So. 2d at 413. In sum, the hiring party who "contracts with an independent contractor to perform certain work or service which is not illegal, dangerous or harmful, is not liable for torts committed by him." Hester v. Bandy, 627 So. 2d 833, 841 (Miss. 1993) (citing Blackmon v. Payne, 510 So. 2d 483, 488 (Miss. 1987)); Mississippi Power Co. v. Brooks, 309 So. 2d 863, 866 (Miss. 1975)).

[15] New Orleans, B.R.V. & M.R.R. Co. v. Norwood, 62 Miss. 565, 566 (1885).

[16] Richardson v. APAC-Mississippi, Inc. 631 So. 2d 143, 149 (Miss. 1994) (citing Fruchter v. Lynch Oil Co., 522 So. 2d 195, 199 (Miss. 1988)). *Accord* Hercules Powder Co. v. Westmoreland, 164 So. 2d 471, 474 (Miss. 1964) (stating "it is exceedingly difficult to define the term 'independent contractor' . . . ."). The classification of independent contractor is used in contrast with the classification of servant, but not with the classification of agent, as both the independent contractor and the servant are agents of their respective principal. Wade v. Traxler Gravel Co., 100 So. 2d 103, 108 (Miss. 1958) (citations omitted). In *Kisner v. Jackson*, 132 So. 90, 91 (Miss. 1931), the court noted that the many varieties of tests and factors have proven that "it is not possible within the limitations of language to lay down a concise definition that will furnish any universal formula, covering all cases."

[17] The weight of Mississippi caselaw holds that the question of whether an independent contractor relationship exists is a question of fact. When a party argued to the supreme court that "the question of whether or not he was an independent contractor or employee is one of law and not of fact," the court responded that such an argument was "misplaced." Champion Cable Constr. Co., v. Monts, 511 So. 2d 924, 927 (Miss. 1987). The agency relationship is "a question of fact for jury determination, and not a question of law." Elder v. Sears, Roebuck & Co., 516 So. 2d 231, 236 (Miss. 1987); *see also* Kight v. Sheppard Bldg. Supply, Inc., 537 So. 2d 1355, 1358 (Miss. 1989) (stating whether relationship is that of agency or independent contractor is question of fact). Furthermore, "[w]hen the facts pertaining to the existence or non-existence of an agency are conflicting, or

ment resolution.[18]

The Mississippi Supreme Court has noted that the distinction between these relationships "inevitably revolv[es] around the idea of control."[19] An independent contractor has

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conflicting inferences may be drawn from the evidence, the question presented is one of fact for the jury . . . and even though the evidence is not full or satisfactory, it is the better practice to submit the question to the trier of fact." *Elder,* 516 So. 2d at 232-33 (quoting 3 AM. JUR. 2D *Agency* § 372 (1986)). Summary judgment is not appropriate as "where one party swears to one version of the matter and another says the opposite." Caldwell v. Alfa Ins. Co., 686 So. 2d 1092, 1095 (Miss. 1996).

[18] The Mississippi Supreme Court has stated that:

> [i]ssues of fact, as a matter of proper construction of Rule 56, also exist where there is more than one reasonable interpretation that may be given undisputed testimony, where materially differing but nevertheless reasonable inferences may be drawn from the uncontradicted facts, or where the purported establishment of the facts has been sufficiently incomplete or inadequate that the trial judge cannot say with reasonable confidence that the full facts of the matter have been disclosed.

Dennis v. Searle, 457 So. 2d 941, 944 (Miss. 1984). Noting the difficulty of determining whether there is a genuine issue of material fact, the supreme court has admonished trial courts that "[i]f there is to be error at the trial level it should be in denying summary judgment and in favor of a full live trial." *Id.* (citations omitted). Stressing the authority of the trial judge, the Mississippi Supreme Court has stated:

> [I]n most situations in which the moving party seems to have discharged his burden of demonstrating that no genuine issue of fact exists, the court has discretion to deny a Rule 56 motion. This is appropriate since even though the summary judgment standard appears to have been met, the court should have the freedom to allow the case to continue when it has any doubt as to the wisdom of terminating the action prior to a full trial.

Donald v. Reeves Transp. Co., 538 So. 2d 1191, 1196 (Miss. 1989) (quoting WRIGHT, MILLER & KANE, FEDERAL PRACTICE AND PROCEDURE § 2728 (2d ed. 1983)).

After all, "all motions for summary judgment should be viewed with great skepticism and if the trial court is to err, it is better to err on the side of denying the motion." Simmons v. Thompson Mach., 631 So. 2d 798, 801 (Miss. 1994) (quoting Claiborne County Bd. of Educ. v. Martin, 500 So. 2d 981, 981 (Miss. 1986)). Even when the moving party has apparently met his burden in its entirety, the judge still has the discretion to deny the motion for summary judgment. *Donald,* 538 So. 2d at 1196. In addition, self-serving affidavits with conclusory statements that one is or is not an independent contractor cannot support summary judgment. *See, e.g.,* Galindo v. Precision Am. Corp., 754 F.2d 1212, 1222 (5th Cir. 1985) (citing Pitts v. Shell Oil Co., 463 F.2d 331, 334 (5th Cir. 1972)).

[19] *Kight,* 537 So. 2d at 1359 (citing *Fruchter,* 522 So. 2d at 199). *See* Duggins

been defined as "one who contracts to do work according to his own methods without being subject to the control of his employer except as to the results of the work."[20] Justice dictates

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v. Guardianship of Washington, 632 So. 2d 420, 426 (Miss. 1993) (stating "the key issue which needs to be analyzed between the parties is control"). In fact, determining whether an individual acts as an independent contractor hinges on the question of control. *Fruchter*, 522 So. 2d at 199. It is the right to control, not the actual control exercised, that is determinative. Boyd v. Crosby Lumber & Mfg. Co., 166 So. 2d 106, 108 (Miss. 1964). The rule of respondeat superior gives a master who has the right to control the incentive to prevent his servant from committing torts. Colvin v. Ellis Constr. Co., 840 F. Supp. 59, 61 (N.D. Miss. 1993).

[20] *Duggins*, 632 So. 2d at 426 (citation omitted). There have been many attempts by the Mississippi Supreme Court to define an "independent contractor." Kughn v. Rex Drilling Co., 64 So. 2d 582, 584-85 (Miss. 1953). The court has defined an independent contractor as "a person who contracts with another to do something for him but who is not controlled by the other nor subject to the other's right to control with respect to his physical conduct in the performance of the undertaking." *Wade*, 100 So. 2d at 107 (citations omitted); *see also* RESTATEMENT (SECOND) OF AGENCY §§ 2, 220 (1933). Under the Mississippi Workers' Compensation Statute, an independent contractor is defined as:

> any individual, firm or corporation who contracts to do a piece of work according to his own methods without being subject to the control of his employer except as to the results of the work, and who has the right to employ and direct the outcome of the workers independent of the employer and free from any superior authority in the employer to say how the specified work shall be done or what the laborers shall do as the work progresses, one who undertakes to produce a given result without being in any way controlled as to the methods by which he attains the result.

MISS. CODE ANN. § 71-3-3(r) (1995).

In contrast, an employee is defined as follows:

> any person, including a minor whether lawfully or unlawfully employed, in the service of an employer under any contract of hire or apprenticeship, written or oral, express or implied, provided that there shall be excluded therefrom all independent contractors and especially any individual performing service in, and at the time of, the sale of newspapers or magazines to ultimate consumers under an arrangement under which the newspapers or magazines are to be sold by the individual at a fixed price, the individual's compensation being based on the retention of the excess of such price over the amount at which the newspapers or magazines are charged to the individual, whether or not the individual is guaranteed a minimum amount of compensation for such service or is entitled to be credited with the unsold newspapers or magazines returned. A student of an educational institution who, as part of such

that a party is usually not liable for the torts of an independent contractor based upon the theory that one "does not possess the power of controlling the person employed as to the details of the work."[21] However, the law becomes complicated in trying to interpret whether the party is actually an independent contractor.[22] Furthermore, the court has admitted

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> educational institution's curriculum, is receiving practical training at any facility, who is under the active and direct supervision of the personnel of the facility and/or an instructor of the educational institution, and who is not receiving wages as a consequence of participation in such practical training shall not be considered an employee of such facility on account of participation in such practical training.

Id. § 71-3-3(d).

Although these definitions are not controlling outside of the workers' compensation context, they are certainly indicative of the Legislature's idea about how these employment relationships should be construed. In *Carr v. Crabtree*, 55 So. 2d 408, 413 (Miss. 1951), the court stated that common law tests as applied in tort actions should also be applied to determine if a person is an employee or an independent contractor under workers' compensation acts.

[21] Ingalls Shipbuilding Corp. v. McDougald, 228 So. 2d 365, 367 (Miss. 1969). If the principal does not control the employee, the principal is not in a position to prevent the employee's torts and, absent independent negligence, should not be held liable for that which he cannot control. Webster v. Mississippi Publishers Corp., 571 So. 2d 946, 952-53 (Miss. 1990) (Robertson, J., dissenting) (citing McDonald v. Hall-Neely Lumber Co., 147 So. 315, 316 (Miss 1933); Kisner v. Jackson, 132 So. 90, 91 (Miss. 1931)). It has long been established that "in any given case, it gets back to the original proposition whether in fact the contractor was actually independent." Brown v. E.L. Bruce Co., 175 So. 2d 151, 154 (Miss. 1965) (citations omitted); *see also* 27 AM. JUR. *Independent Contractors* § 6 (1940) (stating if party is not under employer's control, he is independent contractor). The United States Supreme Court also employs a control test with the critical factors being the determination of the principal's authority to control the detailed physical performance of the contractor and to supervise the contractor's daily operations. *See, e.g.,* United States v. Orleans, 425 U.S. 807, 815 (1976); Logue v. United States, 412 U.S. 521, 527-28 (1973).

[22] *See* Cooks v. Neely Lumber Co., 275 So. 2d 386, 388 (Miss. 1973) (stating numerous tests are simply methods to determine "whether there is true independence in right and in fact"). The Fifth Circuit in analyzing Mississippi Supreme Court decisions concluded that Mississippi initially "engaged in an elaborate factoring analysis" to determine the employment relationship. McKee v. Brimmer, 39 F.3d 94, 96 (5th Cir. 1994). However, the supreme court in W.J. Runyon & Son, Inc. v. Davis, 605 So. 2d 38, 45 (Miss. 1992), shifted to the singular, right to control test, and in Richardson v. APAC-Mississippi, 631 So. 2d 143, 149 (Miss. 1994), the court returned to the factoring analysis. To further complicate determining the status of the employment relationship, a party may be an independent

that "[t]he difficulty in applying these tests can be seen where this Court on quite analogous factual situations has reached opposite conclusions."[23]

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contractor as to certain work and an agent as to other work for the same principal. Russell v. Orr, 700 So. 2d 619, 623 (Miss. 1997) (*citing* Kight v. Sheppard Bldg. Supply, Inc., 537 So. 2d 1355, 1359 (Miss. 1989)); Carroll v. E.G. Laughlin & Sons, 71 So. 2d 461, 463 (Miss. 1954). Also, a relationship which begins as an independent contractor relationship may become such an integral part of the employer's business that the relationship is transformed to that of employer-employee. Brown v. E.L. Bruce Co., 175 So. 2d 151, 156 (Miss. 1965) (citations omitted).

[23] *Richardson*, 631 So. 2d at 149. The employment relationship in *Wade v. Traxler Gravel Co.*, was deemed to be one of employer-employee, not independent contractor. *Wade,* 100 So. 2d at 108. Wade, the alleged "independent contractor," had been hauling gravel for Traxler about a year prior to the accident. *Id.* at 105. There was no written contract between the parties, and Wade (as well as the finance company) owned the truck involved in the accident. *Id.* at 106. The "independent contractors" were paid every two weeks, and no deductions were taken from their check. *Id.* In addition, Traxler Gravel "had no control over whom the truck drivers [alleged independent contractors] hired to operate its trucks." *Id.* at 107. Additional facts include the following:

> [Wade] did not contract to do a set piece of work; his employment was not to last for any specified period of time. Traxler controlled the loading of Wade's truck at the pit; and through the ownership and operation of the loading machinery Traxler controlled in a measure the hours of the day during which Wade could haul gravel. Traxler determined the kind and quantity of gravel that Wade should haul, the distance which the truck was to travel, and the amount of pay that Wade was to receive for delivering the gravel to the purchaser. Wade and Traxler both testified that Wade could quit work at any time that he pleased, and that Traxler might terminate his services at any time that he saw fit to do so. Wade had no distinct occupation or business. He was merely a gravel hauler, and no particular skill was required to haul gravel. Wade was paid every two weeks for his services. These facts, in our opinion, show an employer-employee relationship and not the relationship of an independent contractor.

Id. at 108-09.

The *Wade* court held "[t]he facts in the case, in our opinion, certainly do not bring the appellant [Wade] within the accepted definition of an independent contractor," as if one "engages another to perform certain work, retaining control of the conduct of the person thus engaged with respect to the work to be done or the order, method, and plan of the work, the relation is that of master and servant, and not of employer and independent contractor." *Id.* at 107-08. However, some drivers and haulers have been classified as independent contractors. *See* Hercules Powder Co. v. Westmoreland, 164 So. 2d 471, 475 (Miss. 1964) (finding indepen-

In *Kisner v. Jackson,* the court reviewed and summarized factors to be considered in order to determine whether a relationship constitutes that of an independent contractor.[24] The factors, which were not set out in any order of significance, were as follows:

> Whether the principal master has the power to terminate the contract at will; whether he has the power to fix the price in payment for the work, or vitally controls the manner and time of payment; whether he furnishes the means and appliances for the work; whether he has control of the premises; whether he furnishes the materials upon which the work is done and receives the output thereof, the contractor dealing with no other person in respect to the output; whether he has the right to prescribe and furnish the details of the kind and character of work to be done; whether he has the right to supervise and inspect the work during the course of employment; whether he has the right to direct the details of the manner in which the work is to be done; whether he has the right to employ and discharge the subemployees and to fix their compensation; whether he is obliged to pay the wages of said employees.[25]

Since *Kisner,* the court has continued, on occasion, to enumerate different sets of factors. For example, in *Jones v. James*

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dent contractor relationship where driver owned his own trucks and hired his own employees); Mississippi Power & Light Co. v. Walters, 158 So. 2d 2, 26 (Miss. 1963) (holding hauler was independent contractor); Carr v. Crabtree, 55 So. 2d 408, 413-14 (Miss. 1951) (holding hauler who was paid by unit was independent contractor where hiring party exercised right to inspect work); Crosby Lumber & Mfg. Co. v. Durham, 179 So. 2d 285, 287-88 (Miss. 1938) (holding relationship created was independent contractor relationship even though independent contractor could be terminated at will). *Contra* Bush v. Byrd, 108 So. 2d 211, 211 (Miss. 1959) (determining hauler was employee). The inconsistency may be attributed to the fact that the tests applied are "generalities" which may be given various interpretations by different judges. *Richardson,* 631 So. 2d at 150.

[24] Kisner v. Jackson, 132 So. 90, 91 (Miss. 1931). The *Kisner* factors were reaffirmed by the Mississippi Supreme Court in *Leaf River Forest Prods., Inc. v. Harrison,* 392 So. 2d 1138, 1141-42 (Miss. 1981).

[25] *Kisner*, 132 So. at 91; *see also* Sessums Timber Co. v. McDaniel, 635 So. 2d 875, 881 (Miss. 1994) (stating *Kisner* factors). The results of any enumerated factor may be counterbalanced by the result from another factor. *Id.*

Reeves Contractors, Inc., the court stated that there were three important factors to be considered in analyzing any employment relationship, with the right to control being the determinative factor.[26] Circumstantial evidence may be used to illustrate that a relationship is not truly that of an independent contractor.[27] For instance, lengthy employment acts may destroy an alleged independent contractor defense.[28] The Mississippi Supreme Court stated that "the long continued employment of a person . . . under a contract that may be terminated at will 'strongly indicate[s] . . . [the independent contractor] has assumed the status of an employee under the relationship of master and servant'."[29] When alleged independent contractors "perform continuous service which is an integral part of the employer's business," there is a "growing tendency to classify [the alleged independent contractors] . . . as employees."[30] Ironically, the absolute right of the hiring party to terminate the relationship is also inconsistent with the concept of independent contractor and may destroy the independent contractor defense.[31]

Another significant factor is whether the alleged independent contractor has a regular, independent business which allows the public to hire the contractor for a particular purpose.[32] For the contractor to have a regular, independent business, he or she must have a familiarity with a distinct occupation or business.[33] In addition to the previous factors, the court may also consider whether the hiring party owns and operates the machinery[34] and whether the alleged independent contractor is paid periodic wages by the project performed.[35]

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[26] Jones v. James Reeves Contractors, Inc., 701 So. 2d 774, 779 (Miss. 1997). The three factors are as follows: "(1) whose work is being performed; (2) who has the right to control the worker in his duties on the job; and (3) the existence of an employment contract between the employee and the special employer whether actual or implied." *Id.*

[27] *Blackmon*, 510 So. 2d at 488.

[28] *See Wade*, 100 So. 2d at 108 (quoting RESTATEMENT (SECOND) AGENCY § 220 (1957)).

[29] Powell v. Masonite Corp., 214 So. 2d 469, 470 (Miss. 1968) (quoting Brown v. E.L. Bruce Co., 175 So. 2d 151, 156 (Miss. 1965)).

[30] *Wade*, 100 So. 2d at 109.

[31] *Id.* (citations omitted). The right to terminate the employment relationship is illustrative of the power to control. 3 ARTHUR LARSON & LEX LARSON, LARSON WORKERS' COMPENSATION LAW § 44.35 (1997). The court has stated that "[t]o a poor man needing work, the power to dismiss immediately is equivalent to the power to control." *Wade*, 100 So. 2d at 109 (*quoting* Industrial Comm'n v. Meddock, 180 P.2d 580, 584 (Ariz. 1947)).

[32] Brown v. E.L. Bruce Co., Inc., 175 So. 2d 151, 154 (Miss. 1965) (citing 27

In the landmark case of *Richardson v. APAC-Mississippi, Inc.*,[36] the primary issue was whether the employment relationship between a truck driver and APAC-Mississippi was one of master/servant or independent contractor.[37] First, the court defined an independent contractor as "a person who contracts with another to do something for him but who is not controlled by the other nor subject to the other's right to control with respect to his physical conduct in the performance of the undertaking."[38] In finding that an independent contractor relationship existed, the court relied upon the written contract between the parties evidencing an independent contractor relationship[39] and the affidavit of APAC's safety director which asserted that "APAC did not control how many loads [the truck driver] hauled per day, or how many hours or days he would work. [The truck driver] chose his own times to work, and also chose

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AM. JUR. *Independent Contractors* § 2 (1940)).

[33] 27 AM JUR. *Independent Contractors* § 17, at 499-500 (1940); *see also Wade*, 100 So. 2d at 108 (citing RESTATEMENT (SECOND) AGENCY § 220 (1957)).

[34] *See* Wade v. Traxler Gravel Co., 100 So. 2d 103, 108 (Miss. 1958); *see also* Benjamin v. Davidson-Gulfport Fertilizer Co., 152 So. 839, 840 (Miss. 1934) (finding no independent contractor relationship where hiring party furnished tools, appliances, and necessary equipment necessary); Natchez Coca-Cola Bottling Co. v. Watson, 133 So. 677, 680 (Miss. 1931) (finding where hiring party furnished truck with gas and oil driver of said truck was not independent contractor).

[35] *See also* Wade, 100 So. 2d at 108 (citing RESTATEMENT (SECOND) AGENCY § 220 (1957)).

[36] 631 So. 2d 143 (Miss. 1994).

[37] *Id.* at 148.

[38] *Id.* at 148 (citations omitted).

[39] *Id.* at 144. Although the *Richardson* court upheld the contract between the parties, all contracts defining employment relationships are not binding upon the court and may not be upheld. *See id.* at 150 (stating that "[w]hen . . . third parties are adversely affected, this Court will carefully scrutinize the contract to see if public policy should permit the transformation of an ordinarily employer/employee relationship into that of an independent contractor").

his own routes and methods to complete the job, with no instruction whatsoever from APAC."[40]

B. Public Policy and Financial Responsibility

The right to contract is protected by law and is of the utmost importance to the business community.[41] By contracting to define an employment relationship as that of an independent contractor, the entrepreneur can invoke the independent contractor defense in order to limit his liability exposure.[42] However, the Mississippi Supreme Court, when public policy demands, may refuse to uphold the contract and decline to recognize the classification chosen by the contracting parties.[43] A hiring party cannot contractually create an independent contractor relationship and maintain control over the alleged independent contractor.[44] The court will look beyond the contract to see whether the classification contracted to is the employment relationship that actually exists.[45]

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[40] *Id.* at 144-45. Yet another factor analyzed by the court was whether there existed a right to supervise. *Id.* at 149. Significantly, APAC also submitted an affidavit from the truck driver confirming the statements in the affidavit and stating that "APAC retained no control over his working hours, how many loads he hauled, what routes he took, or how many hours he worked. He decided all such matters himself." *Id.* at 145.

[41] Cooks v. Neely Lumber Co., 275 So. 2d 386, 389 (Miss. 1973); see also U.S. CONST. art. I, § 10; MISS. CONST. art. III, § 16. If an injured third party is not deprived of an adequate legal remedy, the parties are free to contract as they wish. *Richardson,* 631 So. 2d at 151 (citing Mississippi Hill & Delta Sav. & Loan Ass'n v. Valley Bank, 392 So. 2d 1126, 1129 (Miss. 1981)).

[42] Webster v. Mississippi Publishers Corp., 571 So. 2d 946, 952 (Miss. 1990) (Robertson, J., dissenting). The concept of "servant" was designed "to delimit the scope of a master's vicarious tort liability." Sones v. Southern Lumber Co., 60 So. 2d 582, 584 (Miss. 1952) (quoting 4 LARSON'S WORKMEN'S COMPENSATION LAW, § 43.42). Other legal creations that provide a mechanism to limit liability include the formation of a corporation or a limited partnership. *Webster,* 571 So. 2d at 952 (Robertson, J., dissenting). However, there are other safeguards within the law to prevent a party from escaping financial responsibility. *See* Ford v. Lamar Life Ins. Co., 513 So. 2d 880, 888 (Miss. 1987) (citation omitted) (stating that section 83-17-1 of the Mississippi code, which defines an agent, was enacted "to prevent insurers from operating through third persons and later denying responsibility for the acts of those persons").

[43] First Nat'l Bank v. Mississippi Unemployment Compensation Comm'n, 23 So. 2d 534, 536 (Miss. 1945). A court is not bound to the terms of the contract. *E.g.,* Leaf River Forest Prods., Inc. v. Harrison, 392 So. 2d 1138, 1141 (Miss. 1981); Mississippi Employment Sec. Comm'n v. Logan, 159 So. 2d 802, 804 (Miss. 1964). A contract alleging an independent contractor status which is merely a pretense to avoid the unemployment act will not be recognized by the supreme court. *First Nat'l Bank,* 23 So. 2d at 536; *see also Cooks,* 275 So. 2d at 389 (stating that "where the arrangement is in good faith and is not a mere subterfuge or

In *Richardson,* the supreme court specifically added financial responsibility as a factor to consider in analyzing the relationship.[46] The court stated as follows:

> When a contract is made between two parties that as between themselves creates an independent contractor relationship and involves employment generally performed under a simple master/servant or employer/employee relationship, it will be upheld as between the parties. When, however, third parties are adversely affected, this Court will carefully scrutinize the contract to see if public policy should permit the transformation of an ordinarily employer/employee relationship into that of an independent contractor. A necessary condition precedent for the application of this factor, however, is that the party challenging the claimed relationship will be adversely affected, and denied an adequate legal remedy.[47]

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pretense, it will be recognized for what it is . . . ."). Although the court may consider the contract's classification of the employment relationship, the true test is one that "incorporates all the facts and the economic realities." Young v. Tennessee River Pulp & Paper Co., 640 F. Supp. 1162, 1167 (N.D. Miss. 1986) (citations omitted).

[44] Gulf Refining Co. v. Nations, 145 So. 327, 333 (Miss 1933); *see also* McKee v. Brimmer, 39 F.3d 94, 98 (5th Cir. 1994) (stating that "an employer will not be allowed to escape liability by drafting a contract which labels its employee an independent contractor, but retains employer-like control over him").

[45] *Leaf River Forest Prods.*, 392 So. 2d at 1141. The examining court must "pierc[e] through the screen of technical attitudes to what are the realities, and must regard substance rather than formal similitudes." *Id.* (quoting Hederman v. Cox, 193 So. 19, 24 (Miss.1940)).

[46] Richardson v. APAC-Mississippi, Inc., 631 So. 2d 143, 150 (Miss. 1994).

[47] *Id.* The public policy exception did not represent a new philosophy for the Mississippi Supreme Court. In *Hobbs v. International Paper Co.,* 203 So. 2d 488, 490 (Miss. 1967), the court stated:

> [w]here persons and firms put worn-out trucks into the possession of penniless persons, to be operated upon the heavy-laden highways of this state under the guise and legal fiction that such operators are independent contractors . . . when in fact and truth they are financially unable

Therefore, it is incumbent on the party alleging that it will be denied an adequate legal remedy to meet the "necessary condition precedent" and prove that the alleged independent contractor has insufficient resources to provide an adequate legal remedy and is unable to financially respond fully in damages. Additionally, there must be a showing that the party challenging the independent contractor defense will be "adversely affected, and denied an adequate legal remedy" if the alleged employer is permitted to transform the relationship into an independent contractor relationship.[48]

The premise of this public policy exception is that it would be inequitable to allow contracting parties to create legally a factual nuance to escape financial responsibility for injuries to third persons.[49] An employer cannot try to escape vicarious liability and make the alleged employee "an independent contractor and at the same time retain complete control of the business."[50] The Mississippi Supreme Court has yet to interpret significantly the public policy exception promulgated in *Richardson*, and it is not clear how broadly or narrowly the public policy exception will be applied.[51] Further, an examina-

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> to buy gasoline or tags with which to operate the trucks, or even food for themselves, without obtaining advance funds, these facts and circumstances are for the jury's consideration, and may be the turning point in their deliberations [of whether an independent contractor relationship exists].

Id.

Although this public policy factor was expressly added in *Richardson,* the court did not apply the policy as the plaintiff did not claim that the independent contractor was unable financially to respond fully to damages. *Richardson*, 631 So. 2d at 151. Furthermore, the *Richardson* court pointed out that the independent contractor had liability insurance, and the plaintiff had in fact reached a compromise settlement with the independent contractor and his insurance carrier. *Id.*

[48] *Id.* at 150.

[49] Vicarious liability is based upon the doctrine of allocation of risk. *Id.* at 151. It is the hiring party who is financially in a better position to bear the "required costs of doing business" than the "innocent injured plaintiff." *Id.* (*quoting* PAGE KEETON ET AL., PROSSER AND KEETON ON THE LAW OF TORTS § 69 at 500 (5th ed. 1984)).

[50] *Id.* at 150 (quoting Gulf Refining Co. v. Nations, 145 So. 327, 333 (Miss. 1933)).

[51] In *Rolison v. City of Meridian*, 691 So. 2d 440, 441 (Miss. 1997), the plain-

tion of other jurisdictions reveals that there is no uniform application of a public policy exception, and the attempted application of a public policy exception based upon financial responsibility has lead to disparate results.[52]

III. THE SIGNIFICANCE OF EMPLOYMENT CLASSIFICATIONS UNDER TITLE VII

As demonstrated, the court's classification of an employment relationship is significant in establishing an employer's liability to third parties in tort. The classification is also critical in determining whether employers may be subjected to gender or racial discrimination claims by their own "employees."[53] An

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tiff was hit by a bat during a softball game. The plaintiff sued both the player who threw the bat and the City of Meridian, alleging that the city had negligently selected and inadequately trained the umpires. *Id.* The city alleged that the Meridian Umpires Association, an independent contractor, employed the umpires, that the umpires were immune pursuant to § 95-9-3 of the Mississippi Code, and that such immunity flowed to the city. *Id.* The court cited *Richardson* as the controlling precedent and held that the Meridian Umpires Association, an alleged insolvent unincorporated association, was an independent contractor. *Id.* at 445. The *Rolison* court pointed out that the plaintiff had sued the player who threw the bat. *Id.* Although the court did not apply the public policy exception, there is no evidence in the court's opinion that the plaintiff met *Richardson's* condition that he would be "adversely affected, and denied an adequate legal remedy." *Richardson*, 631 So. 2d at 150. There is no evidence that the plaintiff in *Rolison* argued that the financial condition of the negligent player, including his applicable insurance and net worth, was insufficient to provide plaintiff with an adequate remedy. However, the public policy exception promulgated in *Richardson* is still viable, as *Rolison* cited *Richardson* for the proposition that the adverse effect on the rights of a third party would be taken into account. *Rolison*, 691 So. 2d at 445.

[52] *See, e.g.,* Becker v. Interstate Properties, 569 F.2d 1203, 1212 (3d Cir. 1977) (imposing financial responsibility as matter of public policy); Hampton v. McCord, 232 S.E.2d 582, 586 (Ga. Ct. App. 1977) (refusing to adopt financial responsibility exception). *Cf.* Feliberty v. Damon, 527 N.E.2d 261, 264 (N.Y. 1988) (noting growing number of public policy exceptions to independent contractor defense).

[53] Of course, there are other important jurisdictional prerequisites under Title VII. For instance, Title VII's definition of "employer" is just as significant as that of "employee" because the Act prohibits only "employers" from discriminating against their employees. 42 U.S.C. § 2000e-2(a) (1994). Title VII defines "employer" as "a person engaged in an industry affecting commerce who has fifteen or more employees . . . and any agent of such a person." *Id.* § 2000e(b). Exactly who is a Title VII "employer" has been extensively litigated. *See, e.g.,* Gary v.

employer's liability for Title VII violations depends upon whether the claimant is an "employee" *as defined by the Act*, *not* whether the claimant is an "employee" in the traditional sense.[54] If the claimant is not an "employee," the federal courts do not have jurisdiction over the Title VII claim, which must fail as a matter of law.[55] Therefore, whether a particular worker meets Title VII's definition of "employee," is of critical importance in determining whether he or she may enforce the rights granted by that Act.[56]

Long, 59 F.3d 1391, 1395 (D.C. Cir. 1995) (applying common law principles of agency and holding that supervisor was not claimant's "employer" for purposes of Title VII); Sauers v. Salt Lake County, 1 F.3d 1122, 1125 (10th Cir. 1993); Boykin v. Bloomsburg Univ., 893 F. Supp. 409, 418 (M.D. Pa. 1995), *aff'd*, 91 F.3d 122 (3d Cir. 1996) (same); McIlwain v. Korbean Int'l Inv. Corp., 896 F. Supp. 1373, 1378 (S.D.N.Y. 1995) (same); Smith v. Prudential Fin. Servs., Inc., 739 F. Supp. 1042, 1043 (D. S.C. 1990) (holding that co-worker is not "employer" under Title VII); Flowers v. Rego, 691 F. Supp. 177, 179 (E.D. Ark. 1988) (holding non-supervisory co-employee was not "employer" under Title VII); Hendrix v. Fleming Cos., 650 F. Supp. 301, 302 (W.D. Okla. 1986) (stating that "[t]o be an employer for purposes of Title VII, an individual must be an officer, director or supervisor of a Title VII employer, or otherwise involved in managerial decisions."); Duva v. Bridgeport Textron, 632 F. Supp. 880, 882 (E.D. Pa. 1985) (holding supervisory employees qualify as "employers" for purposes of Title VII); Guyette v. Stauffer Chem. Co., 518 F. Supp. 521, 525-26 (D. N.J. 1981) (holding that non-supervisory employee is not Title VII "employer").

[54] *See* Graves v. Women's Prof'l Rodeo Ass'n, 708 F. Supp. 233, 235 (W.D. Ark. 1989) (stating that "[o]nce an employer is covered by the act, Title VII protection extends to any aggrieved individual without regard to the existence of a traditional employment relationship."), *aff'd*, 907 F.2d 71 (8th Cir. 1990).

[55] *See* Barnes v. Colonial Life & Accident Ins. Co., 818 F. Supp. 978, 980 (N.D. Tex. 1993) (citations omitted) (stating that "[u]nder Title VII, federal jurisdiction is invoked only if a claimant is an 'employee.'"); *see also* Diggs v. Harris Hospital-Methodist, Inc., 847 F.2d 270, 272 (5th Cir. 1988)). However, numerous courts have held that a defendant may be liable under Title VII if the defendant discriminatorily interferes with the plaintiff's employment opportunities with third parties, where the defendant controls the access to those opportunities. *See, e.g.*, Pardazi v. Cullman Med. Ctr., 838 F.2d 1155, 1156 (11th Cir. 1988); Doe v. St. Joseph's Hosp., 788 F.2d 411, 422-23 (7th Cir. 1986); Gomez v. Alexian Bros. Hosp., 698 F.2d 1019, 1021 (9th Cir. 1983); Sibley Mem'l Hosp. v. Wilson, 488 F.2d 1338, 1341 (D.C. Cir. 1973); *see also* Andrew O. Schiff, Note, *The Liability of Third Parties Under Title VII*, 18 U. MICH. J.L. REFORM 167 (1984).

[56] 1 A. LARSON & L. LARSON, EMPLOYMENT DISCRIMINATION § 5.21, at 2-9 (1991). The discrimination targeted by Title VII "relates to the field of employment." *Id.*; Mitchell v. Frank R. Howard Mem'l Hosp., 853 F.2d 762, 766 (9th Cir. 1988); *Gomez*, 698 F.2d at 1021; Lutcher v. Musicians Union Local 47, 633 F.2d

Unfortunately, Title VII's statutory definition of "employee," which states that an "employee" is "an individual employed by an employer,"[57] is anything but helpful.[58] Yet, classification as a Title VII "employee" is crucial, not only for Title VII purposes, but also because the courts have held that the definition of "employee" under Title VII is also applicable to the ADEA,[59] and, in some instances, to the FLSA.[60] To determine

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880, 883 (9th Cir. 1980); *Graves*, 708 F. Supp. at 235, *aff'd*, 907 F.2d 71 (8th Cir. 1990). To travel under Title VII, the claimant must establish that the "parties fall within the definitions of the statute." Holloman v. Northeast Georgia Area Dev. Comm'n, 740 F. Supp. 1571, 1575 (M.D. Ga. 1990).

[57] 42 U.S.C. § 2000e(f) (1994).

[58] *See* Broussard v. L.H. Bossier, Inc., 789 F.2d 1158, 1159-60 (5th Cir. 1986) (stating that Title VII's definition of "employee" is work of "magnificent circularity"); Calderon v. Martin County, 639 F.2d 271, 272-73 (5th Cir. 1981) (stating Title VII gives little statutory guidance as to who is "employee"); Kellam v. Snelling Personnel Servs., 866 F. Supp. 812, 814 (D. Del. 1994) (stating that Title VII's definition of "employee" is "unavailing" and "remarkabl[y] circular"), *aff'd*, 65 F.3d 162 (3d Cir. 1995); Smith v. Berks Community Television, 657 F. Supp. 794, 795 (E.D. Pa. 1987); *see also* Kachmar v. SunGard Data Sys., Inc., 109 F.3d 173, 179 (3d Cir. 1997) (stating that "Title VII defines the 'employee' who can bring suit in broad terms.").

[59] *See* Lorillard v. Pons, 434 U.S. 575, 584 (1978) (stating that "[t]he prohibitions of the ADEA were derived *in haec verba* from Title VII"); Birbeck v. Marvel Lighting Corp., 30 F.3d 507, 510 (4th Cir. 1994) (calling Title VII ADEA's "closest statutory kin"); Rogers v. Sugar Tree Prods., Inc., 7 F.3d 577, 581 (7th Cir. 1993) (holding that Title VII standard for determining employee status applies equally to ADEA claim); Deal v. State Farm County Mut. Ins. Co., 5 F.3d 117, 118-19 (5th Cir. 1993) (applying same test under ADEA and Title VII to determine whether employment relationship exists); Fields v. Hallsville Indep. Sch. Dist., 906 F.2d 1017, 1020-21 n.7 (5th Cir. 1990) (stating that definition of "employee" under ADEA and Title VII are identical); United States EEOC v. Metropolitan Educ. Enters., Inc., 864 F. Supp. 71, 73 (N.D. Ill. 1994) (holding that cases interpreting Title VII may be used in interpreting ADEA, and "vice versa"); Stouch v. Brothers of Order of Hermites, 836 F. Supp. 1134, 1139 (E.D. Pa. 1993) (applying Title VII analysis to ADEA's definition of employee). *But cf.* Hayden v. La-Z-Boy Chair Co., 9 F.3d 617, 620 (7th Cir. 1993) (disagreeing with assumption that Title VII standing automatically confers ADEA standing).

[60] *See e.g.*, Krijn v. Pogue Simone Real Estate Co., 752 F. Supp. 102, 104 n.2 (S.D.N.Y. 1990). In *Krijn*, the court stated that "[s]ince [the FLSA, Title VII, and the ADEA] have a similar purpose — to stamp out discrimination in various forms — cases construing the definitional provisions of one are persuasive authority when interpreting the others." *Id.* (quoting Hyland v. New Haven Radiology Assocs., 794 F.2d 793, 796 (2d Cir. 1986)). *But see* Wilde v. County of Kandiyohi, 15 F.3d 103, 105 (8th Cir. 1994) (providing that "Title VII and the [ADEA] do

employee status within Title VII's broad and circular definition, the courts look to federal case law rather than to any particular state's laws.[61] Federal courts have used three different tests to determine whether a claimant is an "employee" under Title VII:[62] (1) the common law "right to control" test; (2) the "economic realities" test; and (3) the hybrid economic realities-common law control test.[63] Regardless of the test applied, the

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not include the FLSA's expansive definition of the term 'employ'"); Carrell v. Sunland Const., Inc., 998 F.2d 330, 332 (5th Cir. 1993) (applying "economic realities" test under FLSA and "hybrid test" for purposes of Title VII). Actually, courts interpreting the word "employee" for purposes of the FLSA generally use the expansive "economic realities" test, whereas most courts now use the more restrictive "hybrid test" when defining "employee" under Title VII. *See, e.g.*, Diggs v. Harris Hospital-Methodist, Inc., 847 F.2d 270, 272 n.1 (5th Cir. 1988). Thus, only where courts use the "economic realities" test to distinguish between "employees" and independent contractors for purposes of Title VII is the definition interchangeable.

[61] *See, e.g.,* Calderon v. Martin County, 639 F.2d 271, 272-73 (5th Cir. 1981); *Kellam*, 866 F. Supp. at 814, *aff'd*, 65 F.3d 162 (3d Cir. 1995); *Smith*, 657 F. Supp. at 795 (holding that whether one is "employee" for purpose of Title VII jurisdiction is question of federal law); Amarnare v. Merrill Lynch, Pierce, Fenner & Smith, Inc. 611 F. Supp. 344, 347 (S.D.N.Y. 1984), *aff'd*, Aharnare v. Merrill Lynch, 770 F.2d 157 (2d Cir. 1985).

[62] *See* Mares v. Marsh, 777 F.2d 1066, 1067 (5th Cir. 1985) (stating "[t]hree tests have been devised by the courts to unravel the employee/independent contractor conundrum").

[63] Norman v. Levy, 767 F. Supp. 1441, 1444 (N.D. Ill. 1991). The different tests often yield disparate, inconsistent results. *See* Rick A. Pacynski, *Legal Challenges in Using Independent Contractors*, 72 MICH. B.J. 671, 674 (1993). To determine who is and who is not an independent contractor, the Internal Revenue Service uses a series of twenty factors which generally encompasses three more basic sets of factors — the control test, the organization test and the entrepreneur, or "economic realities" test. *Id.* at 673. Predictably enough, the IRS's test for determining independent contractor verses "employee" status is most comprehensive, and consists of the following factors:

> (1) Is the worker required to comply with instruction about when, where and how the work is to be done? (2) Is the worker provided training that would enable him or her to perform a job in a particular method or manner? (3) Are the services provided by the worker an integral part of the business' operations? (4) Must the services be rendered personally? (5) Does the business hire, supervise or pay assistants to help the worker on the job? (6) Is there a continuing relationship between the worker and the person for whom services are performed? (7) Does the recipient of the services set the work schedules? (8) Is the worker required to devote his or her full time to the person he or she performs services

court will always look beyond an individual's contractually conferred label and analyze each case on its own facts.[64]

A. *The Common Law-Agency "Right to Control" Test*

The common law-agency test is the most restrictive of the three tests[65] and is disfavored by most courts.[66] This test is also known as the agency test, and it focuses upon the employer's right to control the employee/independent contractor.[67] This rather simplistic test was articulated in *Krijn v.*

> for? (9) Is the work performed at the place of business of the company, or at specific places designated by the company? (10) Does the recipient of the services direct the sequence in which the work must be done? (11) Are regular oral or written reports required to be submitted by the worker? (12) Is the method of payment hourly, weekly or monthly (as opposed to commission or by the job)? (13) Are business and/or travel expenses reimbursed? (14) Does the company furnish tools and materials used by the worker? (15) Has the worker failed to invest in equipment or facilities used to provide the services? (16) Does the arrangement put the person in the position of realizing either a loss or a profit on the work? (17) Does the worker perform services exclusively for the company rather than working for a number of companies? (18) Does the worker in fact not make his or her services regularly available to the general public? (19) Is the worker subject to dismissal for reasons other than nonperformance of contract specifications? and (20) Can the worker terminate his or her relationship without incurring a liability for failure to complete a job?

Id. at 677 n.5 (citing IRS Rev. Rul. 87-41, 1987-1 C.B. 296).

[64] *See, e.g.,* EEOC v. First Catholic Slovak Ladies Ass'n, 694 F.2d 1068, 1070 (6th Cir. 1982); Mukhtar v. Castleton Serv. Corp., 920 F. Supp. 934, 938 (S.D. Ind. 1996); EEOC v. Pettegrove Truck Serv., Inc., 716 F. Supp. 1430, 1433 (S.D. Fla. 1989); Dixon v. Burman, 593 F. Supp. 6, 9 (N.D. Ind. 1983) (refusing to recognize parties' own designation of "independent contractor" and stating court would "not elevate an employment contract so as to permit it to be used to waive [congressional] protections granted plaintiff"), *aff'd*, 742 F.2d 1459 (7th Cir. 1984); Spirides v. Reinhardt, 486 F. Supp. 685, 687 (D.C.C. 1980) (holding that designation used by parties in contract was not binding for purposes of determining whether plaintiff is "employee," but instead was only one factor to be considered).

[65] Vakharia v. Swedish Covenant Hosp., 765 F. Supp. 461, 466 (N.D. Ill. 1991).

[66] *See* King v. Dalton, 895 F. Supp. 831, 838 (E.D. Va. 1995) (citing Bartels v. Birmingham, 332 U.S. 126 (1947)) (stating that "right to control" test has been rejected as "unnecessarily rigid").

[67] Nowlin v. Resolution Trust Corp., 33 F.3d 498, 505 (5th Cir. 1994).

Pogue Simone Real Estate Co.,[68] where a real estate agent brought a Title VII action against her "employer" alleging that she had been discharged because of her gender and national origin.[69] The court stated that "[t]o distinguish employees from independent contractors: [t]he test entails consideration of numerous circumstances relating to the work relationship, with the most important factor being the extent of the employer's right to control the means and manner of the employee's performance."[70] In applying the agency test, the court found that the defendant neither withheld taxes from the claimant's wages nor provided the claimant with benefits.[71] The court focused on the fact that the defendant did not require the claimant to keep regular office hours, did not dictate the "details" and "means" by which the claimant performed her job, and maintained "little other control over its sales force."[72] Accordingly, the court held that the real estate agent was an independent contractor rather than an "employee" and dismissed her case.[73]

B. The "Economic Realities" Test

The "economic realities" test turns on "whether the employee realistically is dependent upon the business to which he or she renders service."[74] Most courts have concluded that this test is too expansive to be used in Title VII cases[75] because, in emphasizing the broad remedial goals of Title VII, the test extends "coverage to all those who are in a position to suffer the harm the statute is designed to prevent, *unless specifically excluded*."[76] Moreover, the United States Supreme Court, in *Nationwide Mutual Insurance Co. v. Darden*,[77] an ERISA case, stated that where a statute does not specifically define the term "employee," courts should not supply a definition which is broader than that provided by the common law.[78] In *Darden*, the Court expressly rejected the lower court's holding that "employee" should be construed "'in the light of the mischief to be corrected and the end to be attained'" by the legislation.[79] This, of course, is the very standard used by courts applying the "pure" economic realities test.

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[68] 752 F. Supp. 102 (S.D.N.Y. 1990), *aff'd*, 930 F.2d 910 (2d Cir. 1991).

[69] *Krijn*, 752 F. Supp. at 102-03.

[70] *Id.* at 104.

[71] *Id.*

[72] *Id.*

[73] *Id.* at 105. *See also* Jenkins v. Travelers Ins. Co., 436 F. Supp. 950, 952 (D. Or. 1977) (holding that where employer lacked right to control or direct the claimant insurance agent was independent contractor); Smith v. Dutra Trucking Co., 410 F. Supp. 513, 516-17 (N.D. Cal. 1976) (applying common law agency-"right to control" test, holding that claimant engaged in trucking business was independent contractor rather than "employee" for purposes of Title VII), *aff'd*, 580 F.2d 1054 (9th Cir. 1978).

[74] *See* Nowlin v. Resolution Trust Corp., 33 F.3d 498, 505 (5th Cir. 1994) (citing Mares v. Marsh, 777 F.2d 1066, 1067 (5th Cir. 1985)).

[75] *See, e.g.*, Wilde v. County of Kandiyohi, 15 F.3d 103, 105 (8th Cir. 1994). The "economic realities" test has also been criticized as simply being a

Where courts have taken this straightforward approach, without consideration of detailed factors, the economic realities test can indeed cast a broad net.[80] For instance, in *Armbruster v. Quinn*,[81] the court applied the economic realities test and found that a manufacturer's representatives were "employees" for Title VII purposes, notwithstanding the fact that the representatives: did not work out of the corporate office; sold other product lines besides those of the hiring party; were paid no salary other than the commissions they generated; were not restricted as to their work hours, the timing of their sales calls, nor the customers they called upon; and no income or other taxes were withheld from their wages.[82]

In *Vakharia v. Swedish Covenant Hospital*,[83] the court

"rearticulat[ion] and appl[ication] of common law agency principles." Perry v. City of Country Club Hills, 607 F. Supp. 771, 773 n.2 (E.D. Mo. 1983).

[76] Armbruster v. Quinn, 711 F.2d 1332, 1341 (6th Cir. 1983) (emphasis added). Basically, this test attempts to decide whether a worker is likely to be susceptible to the discriminatory practices Title VII was designed to eliminate. *Id.*

[77] 503 U.S. 318 (1992).

[78] *Darden*, 503 U.S. at 323.

[79] *Id.* at 324 (*quoting* NLRB v. Hearst Publications, 322 U.S. 111, 124 (1944)).

[80] *But see* Smith v. Berks Community Television, 657 F. Supp. 794, 795 (E.D. Pa. 1987) (stating that "[u]npaid volunteers are not susceptible to the discriminatory practices which [Title VII] was designed to eliminate").

[81] 711 F.2d 1332 (6th Cir. 1983).

[82] *Id.* at 1339.

[83] 765 F. Supp. 461 (N.D. Ill. 1991).

rejected the hybrid test in favor of the "more expansive standard" embodied by the pure economic realities test.[84] Applying this test, the court found that "an employment relationship" existed between an anesthesiologist and a hospital based upon the fact that the claimant

> did not have an outside practice or outside patients whom she would admit to the Hospital as she deemed necessary; rather, she obtained patients through assignment by the Hospital and referral by staff surgeons at the Hospital who requested her services. The Hospital . . . was able to cut back on her workload by assigning her fewer cases and designating her as a "junior" anesthesiologist, which disqualified her from using nurse anesthetists to assist in procedures. This reduction forced her to cut her insurance to part-time and limit the number of days each week that she worked at the Hospital.[85]

However, other courts purporting to use the economic realities test[86] have focused on the following factors to determine whether a claimant is an "employee" under Title VII:

> (1) [T]he extent of the employer's control and supervision over the worker, including directions on scheduling and performance of work, (2) the kind of occupation and nature of skill required, including whether skills are obtained in the workplace, (3) responsibility for the costs of operation, such as equipment, supplies, fees, licenses, workplace, and maintenance of operations, (4) method and form of payment and benefits, and (5) length of job commitment and/or expectations.[87]

These same courts place particular emphasis upon the employer's right to control the claimant's job performance.[88]

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[84] *Id.* at 466. The court stated that the Seventh Circuit standard was the "economic realities" test, based upon a rejection of the "neat dichotomy between employees and independent contractors" set out by the hybrid test. *Id.* at 466-67.

[85] *Id.* at 468.

[86] *See* Perry v. City of Country Club Hills, 607 F. Supp. 771, 773 n.2 (E.D. Mo. 1983) (stating that "although some courts suggest an 'economic realities' test . . . , they simply rearticulate and apply common law agency principles.").

[87] *See, e.g.,* Knight v. United Farm Bureau Mut. Ins. Co., 742 F. Supp. 518, 521 (N.D. Ind. 1990), *aff'd,* 950 F.2d 377 (7th Cir. 1991).

The application of these five factors has at times operated to exclude claimants from coverage, even though the use of a *pure* economic realities test (*i.e.*, *sans* factors, considering only whether the particular claimant is "specifically excluded" by Title VII) would probably yield a different result.[89] For example, in *Knight v. United Farm Bureau Mutual Insurance Co.*,[90] the court held that the claimant was an independent contractor based upon circumstances substantially similar to those found in *Armbruster*:[91] (1) the claimant was not restricted in which customers she could contact; (2) she was free to choose her working hours; and (3) she received no paid vacations.[92]

C. The "Hybrid" Common Law-Economic Realities Test

As its name suggests, "[t]he hybrid test steers a middle ground, focusing on the 'extent of the employer's right to control the 'means and manner' of the worker's performance.'"[93]

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[88] See Alexander v. Rush North Shore Med. Ctr., 101 F.3d 487, 492-93 (7th Cir. 1996), *overruling* Doe v. St. Joseph's Hosp., 788 F.2d 411 (7th Cir. 1986) (calling five-factor standard "common law test," and holding that physician with staff privileges at hospital was independent contractor); Ost v. West Suburban Travelers Limousine, Inc., 88 F.3d 435, 438-39 (7th Cir. 1996) (holding that airport limousine driver was independent contractor where driver chose own work hours and limousine service otherwise exercised little control over driver); Jones v. Seko Messenger, Inc., 955 F. Supp. 931, 933-34 (N.D. Ill. 1997) (holding messenger service driver was not "employee" where she provided her own vehicle, paid all her expenses and chose her own work assignments); *Knight*, 742 F. Supp. at 521 (focusing on employer's right to control work and determining Title VII claimant was independent contractor, not employee).

[89] *See, e.g.*, Knight, 742 F. Supp. at 522-24; *see also* Dixon v. Burman, 593 F. Supp. 6, 12 (N.D. Ind. 1983) (holding insurance agent was not "employee" where agency for whom she worked did not exercise control over details of agent's work and paid only commission based on agent's production), *aff'd*, 742 F.2d 1459 (7th Cir. 1984); *but see also* Neff v. Civil Air Patrol, 916 F. Supp. 710, 714-15 (S.D. Ohio 1996) (holding that "economic realities" test did not bring civil air patrol member into definition of "employee" where member received no wages or other tangible benefits from air patrol); EEOC v. Pettegrove Truck Serv., Inc., 716 F. Supp. 1430, 1433 (S.D. Fla. 1989) (classifying two members of family business as "employees" for purpose of determining business' status as statutory "employer").

[90] 742 F. Supp. 518 (N.D. Ind. 1990).

[91] *See supra* notes 81, 82 and accompanying text.

[92] *Knight*, 742 F. Supp. at 522.

[93] Nowlin v. Resolution Trust Corp., 33 F.3d 498, 505 (5th Cir. 1994) (*quoting*

The hybrid test borrows from both the common law-agency and economic realities tests above, incorporating factors from each.[94] In applying the test, the court will analyze the following factors to ascertain whether a claimant is an "employee" or an independent contractor:

> (1) kind of occupation, with reference to whether the work is done under the direction of a supervisor or is done by a specialist without supervision; (2) skill required in the particular occupation; (3) source of payment for the office and equipment; (4) length of time the claimant has worked; (5) method of payment, whether by time or by the job; (6) manner in which the work relationship is terminated, whether by one or both parties, with or without notice and explanation; (7) availability of annual leave; (8) nature of the work, whether an integral part of the defendant's business; (9) accumulation of retirement benefits; (10) payment of social security taxes; and (11) intention of the parties.[95]

Although the factors are granted equal weight and no single factor is determinative,[96] a court applying this test will pay particular attention to the employer's right to control the worker's means and manner of performance.[97]

Mares v. Marsh, 777 F.2d 1066, 1067 (5th Cir. 1985)).

[94] Beverly v. Douglas, 591 F. Supp. 1321, 1326 (S.D.N.Y. 1984). "Determination of whether an individual is an employee for the purposes of Title VII requires an analysis of the 'economic realities' of the situation 'viewed in light of the common law principles of agency and the right of the employer to control the employee.'" *Id.* (citing Cobb v. Sun Papers, Inc., 673 F.2d 337, 341 (11th Cir. 1982)); *see also* Diggs v. Harris Hospital-Methodist, Inc., 847 F.2d 270, 272 n.1 (5th Cir. 1988) (stating that hybrid test combines economic realities test used in FLSA cases with common law agency principles, focusing on employer's right to control manner and means of worker's performance); Wilde v. County of Kandiyohi, 15 F.3d 103, 105 (8th Cir. 1994) (stating that hybrid test consists of "common-law factors listed in the Restatement [(Second) of Agency] and some additional factors related to the worker's economic situation").

[95] Barnes v. Colonial Life & Accident Ins. Co., 818 F. Supp. 978, 980 (N.D. Tex. 1993) (citing Spirides v. Reinhardt, 613 F.2d 826, 832 (D.C. Cir. 1979), *aff'd*, 656 F.2d 900 (D.C. Cir. 1981)).

[96] Deal v. State Farm County Mut. Ins. Co., 5 F.3d 117, 118-19 (5th Cir. 1993); *Spirides*, 613 F.2d at 831, *aff'd*, 656 F.2d 900 (D.C. Cir. 1981).

[97] *Id.* The employer's right to control the worker's performance was the most important factor at common law. *Id.* The Restatement (Second) of Agency § 2

The hybrid test was first announced in *Spirides v. Reinhardt*.[98] In fashioning the hybrid test, the *Spirides* court relied heavily upon the common law test set forth in the Restatement (Second) of Agency, as well as federal court interpretations of other statutes having similar remedial objectives as Title VII.[99] In the nineteen years following *Spirides*, almost all of the circuit courts of appeal have adopted the hybrid test.[100] The Fifth Circuit adopted the hybrid test in 1985 in *Mares v.*

(1957) provides:

> (2) A servant [more recently termed "employee"] is an agent employed by a master to perform service in his affairs whose *physical conduct in the performance of the service is controlled* or is subject to the right to control by the master.
>
> (3) An independent contractor is a person who contracts to work with another to do something for him *but who is not controlled* by the other nor subject to the other's right to control *with respect to his physical conduct in the performance of the undertaking* (Emphasis added).

Id. at 831 n.26.

[98] 613 F.2d 826 (D.C. Cir. 1979), *aff'd*, 656 F.2d 900 (D.C. Cir. 1981). The case came to the *Spirides* court on appeal from the United States District Court for the District of Columbia, which granted the defendant's motion for summary judgment, relying almost exclusively on the language in the contract between the parties, that characterized the claimant as an independent contractor. *Id.* at 832. The court remanded the case back to the district court with instructions to apply the eleven-factor test. *Id.* at 833-34. Interestingly, on remand, the district court applied these factors to the case and, nonetheless, found that the claimant was an independent contractor rather an "employee" for purposes of Title VII. Spirides v. Reinhardt, 486 F. Supp. 685, 688 (D.D.C. 1980), *aff'd*, 656 F.2d 900 (D.C. Cir. 1981). The district court found that the claimant was paid per assignment, did not receive annual or sick leave, received no retirement credits, had no hospitalization insurance, and the defendant did not withhold taxes from the claimant's wages. *Spirides*, 486 F. Supp. at 688. Accordingly, the district court again granted the defendant's motion for summary judgment. *Id.* at 689-90.

[99] *Spirides*, 613 F.2d at 831-32, nn.23-28.

[100] *See* Nowlin v. Resolution Trust Corp., 33 F.3d 498, 506-07 & n.17 (5th Cir. 1994); Wilde v. County of Kandiyohi, 15 F.3d 103, 105 (8th Cir. 1994); Oestman v. National Farmers Union Ins. Co., 958 F.2d 303, 305 (10th Cir. 1992); Mares v. Marsh, 777 F.2d 1066, 1067-68 & n.2 (5th Cir. 1985); Garrett v. Phillips Mills, Inc., 721 F.2d 979, 981-82 (4th Cir. 1983); EEOC v. Zippo Mfg. Co., 713 F.2d 32, 37-38 (3d Cir. 1983); Cobb v. Sun Papers, Inc., 673 F.2d 337, 340- 41 (11th Cir. 1982); Unger v. Consolidated Foods Corp., 657 F.2d 909, 915 n.8 (7th Cir. 1981); Lutcher v. Musicians Union Local 47, 633 F.2d 880, 883 & n.5 (9th Cir. 1980); *Sprides*, 613 F.2d at 831-32, *aff'd*, 656 F.2d 900 (D.C. Cir. 1981).

Marsh.[101] Further, the United States Supreme Court applied a substantially similar test in defining "employee" under ERISA.[102]

At a minimum, the widespread adoption of the hybrid test has promoted a more careful and detailed review of the Title VII "employee" issue. The outcome of each case is intensely fact dependent,[103] and there appear to be few hard and fast rules applicable to general categories of workers. Such is illustrated by an examination of some of the cases applying the hybrid test.[104] Courts have held that attorneys hired by cities as municipal judges, prosecuting attorneys, and city attorneys;[105] voluntary hospital staff physicians;[106] a grocery bagger at an

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[101] 777 F.2d 1066, 1067 n.2 (5th Cir. 1985).

[102] Nationwide Mut. Ins. Co. v. Darden, 503 U.S. 318 (1992). In *Darden*, the Supreme Court set out the common law test as follows:

> In determining whether a hired party is an employee under the general common law of agency, we consider the manner and means by which the product is accomplished. Among the other factors relevant to this inquiry are the skill required; the source of the instrumentalities and tools; the location of the work; the duration of the relationship between the parties; whether the hiring party has the right to assign additional projects to the hired party; the extent of the hired party's discretion over when and how long to work; the method of payment; the hired party's role in hiring and paying assistants; whether the work is part of the regular business of the hiring party; whether the hiring party is in business; the provision of employee benefits; and the tax treatment of the hired party.

Id. at 323-24 (quoting Community for Creative Non-Violence v. Reid, 490 U.S. 730, 751-52 (1989)); *cf.* RESTATEMENT (SECOND) OF AGENCY § 220(2) (1958).

At least one court has held that *Darden* requires an application of the common law-agency test rather than the hybrid test in determining whether someone is an employee for purposes of Title VII. *See* Walker v. Correctional Med. Sys., 886 F. Supp. 515, 520 (W.D. Pa. 1995).

[103] *See* McClure v. Salvation Army, 460 F.2d 553, 557 (5th Cir.) (holding that employee status must turn on facts of each case).

[104] For instance, in *Holloman Northeast Ga. Area Dev. Comm'n*, a county nutrition coordinator was determined to be an independent contractor rather than a county employee. Holloman v. Northeast Ga. Area Dev. Comm'n, 740 F. Supp. 1571, 1578 (M.D. Ga. 1990). Although the court purported to apply the "common law agency test," it applied the eleven factors of the Hybrid Test and found dispositive that the defendant did not specify when the claimant was to perform her duties; no annual leave was provided to the claimant; the claimant was not told the details of how to perform her job; there was no direct supervision over the claimant's day-to-day activities; the claimant and defendant had entered into a contract in which the claimant was called the "contractor"; and the claimant's job was not critical to the defendant's operations. *Holloman*, 740 F. Supp. at 1577-78. In *Broussard*, the court held that an owner and operator of a truck was an inde-

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pendent contractor. Broussard v. Bossier, 789 F.2d 1158, 1160-61 (5th Cir. 1986). The court found that the defendant exercised no control over the claimant, noting that the claimant had no taxes withheld from her wages, worked for nine other companies intermittently during the same time she worked for the defendant, was not paid directly by the defendant, and was paid variable rates for her work. *Id.* at 1160-61. In *Aguirre v. McCaw RRC Comm., Inc.*, the court held that telecommunications dealers were not Title VII "employees" where they were essentially unsupervised, and telecommunications corporation did not control means and manner of dealers' performance. Aguirre v. McCaw RRC Comm., Inc., 953 F. Supp. 1222, 1228 (D. Kan. 1997) (holding that dealers were not Title VII "employees" where they were essentially unsupervised, and telecommunications corporation did not control means and manner of dealers' performances). An accountant who performed computer payroll accounting services was an "independent contractor." Goudeau v. Dental Health Servs., Inc., 901 F. Supp. 1139, 1145 (M.D. La. 1995). An insurance agent was not a Title VII "employee." *See* Barnes v. Colonial Life & Accident Ins. Co., 818 F. Supp. 978, 980 (N.D. Tex. 1993); Wright v. State Farm Mut. Auto. Ins. Co., 911 F. Supp. 1364, 1372 (D. Kan. 1995) (insurance agent was independent contractor, not employee), *aff'd*, 94 F.3d 657 (10th Cir. 1996).

[105] Perry v. City of Country Club Hills, 607 F. Supp. 771, 774 (D.C. Mo. 1984). In that case:

> The City maintains no control over how or when these attorneys perform their duties. The City withholds no monies from their fees for taxes or Social Security, nor does the City give them vacation or compensatory time, all of which the City does for its employees. The City does not provide the attorneys with an office, phone or the supplies necessary to do their respective jobs for the City; each attorney works out of his own office which he provides.

Perry, 607 F. Supp. at 774.

[106] Beverly v. Douglas, 591 F. Supp. 1321, 1327 (S.D.N.Y. 1984). The court stated:

> Physicians with voluntary privileges have practices outside the Hospital and are self-employed or are professional corporations. Full-time attending staff members are paid a salary by the Hospital, from which income and social security taxes are withheld, while voluntary staff members receive no salary. The licensing fees and professional dues of full-time attending physicians are paid by the Hospital, which also provides them with retirement benefits, health and life insurance, and coverage under the Hospital's malpractice insurance policy; voluntary attending staff members receive no such benefits . . . [T]he voluntary staff members have no offices at the Hospital. The Hospital exercises some control over the work of its full-time attending physicians — it can direct staff members to work at affiliated hospitals, for example, and can hold full-time attending physicians accountable for their time. No such control is exercised over voluntary attending doctors.

army post commissary;[107] teachers;[108] and a sales representative[109] were not "employees" for Title VII purposes, but that a temporary worker provided by an "employee leasing" agency was a Title VII "employee" of the company which obtained her services.[110]

Id. at 1327; *cf.* Cilecek v. Inova Health Sys. Servs., 115 F.3d 256, 260 (4th Cir. 1997) (labeling standard used as "common law" test, but utilizing essentially same factors as set out in Hybrid Test, holding that physician under contract to provide emergency medical services at hospital was independent contractor); Diggs v. Harris Hospital-Methodist, Inc., 847 F.2d 270, 273 (5th Cir. 1988) (holding provisional staff physician was not "employee" of hospital).

[107] Mares v. Marsh, 777 F.2d 1066, 1069 (5th Cir. 1985). In holding that the claimants were not Title VII "employees," the court observed:

> In addition to the absence of control, other factors demonstrate that the baggers were not Army employees. The baggers received no wages from any source; their exclusive compensation came from tips. Baggers received no annual or medical leave, insurance or retirement benefits, or any other thing of value from the Army. Since the baggers were not paid, the Army did not report their income or withhold and report W/H or FICA taxes. The work arrangements and duty schedules were subject to the exclusive authority of the head bagger, a person selected by the baggers themselves, without any Army input whatever.

Mares, 777 F.2d at 1068-69.

[108] *See* Fields v. Hallsville Indep. Sch. Dist., 906 F.2d 1017, 1020 (5th Cir. 1990) (finding "no evidence . . . that the State played any role in the general hiring or firing of teachers, [or] that the State was involved in the daily supervision of teachers"); *cf.* Zinn v. McKune, 949 F. Supp. 1530, 1535 (D. Kan. 1996) (holding that nurse who was employed by private corporation which contracted with state department of corrections to provide medical services to inmates was not employee of department); Lambertsen v. Utah Dept. of Corrections, 922 F. Supp. 533, 537 (D. Utah 1995) (holding that employment relationship did not exist between teacher and department of corrections), *aff'd*, 79 F.3d 1024 (10th Cir. 1996).

[109] *See* Lane v. David P. Jacobson & Co., 880 F. Supp. 1091, 1099 (E.D. Va. 1995) (holding sales representative was not "employee" where hiring party exercised little control over her day-to-day activities, sales representative received no benefits, and worked for at least one other company while also working for defendant). *Cf.* EEOC v. Fawn Vendors, Inc., 965 F. Supp. 909, 912-13 (S.D. Tex. 1996) (holding that sales representative was "employee" where, although she was paid on commission basis and sales contract indicated she was "independent contractor," corporation monitored sales representative's activities through daily report, provided her with leads, instructed her as to details of sales approach she was to take, and did not permit her to sell vending machines for any other company).

[110] Amarnare v. Merrill Lynch, Pierce, Fenner & Smith, Inc., 611 F. Supp. 344,

IV. CONCLUSION

The question of whether a worker is in fact an agent, servant, employee, or independent contractor is critical in determining the hiring party's potential liability exposure in tort and under Title VII, as well as other federal labor statutes.[111] In recent years, however, the increasingly popular trend among hiring parties has been to hire independent contractors and other workers who do not fit the historically conventional employment arrangement.[112] This has rendered the traditional employee-independent contractor template inadequate, and the courts have struggled in their efforts to make the distinction.[113] The tests used to determine who is an employee or independent contractor are different under Title VII than for purposes of assessing vicarious liability in tort.[114] However, the common thread running through the various tests is "the employer's right to control the means and manner" of the employee's work performance.[115] The presence and predominance of this factor in any test used to distinguish between agents, servants, employees, and independent contractors in-

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349 (S.D.N.Y. 1984), *aff'd*, Aharnare v. Merrill Lynch, 770 F.2d 157 (2d Cir. 1985). In this unusual case, Merrill Lynch obtained the claimant's services through a temporary employment agency called "Mature Temps." *Id.* The claimant was paid directly by Mature Temps, and she never received a paycheck from Merrill Lynch. *Id.* Yet, the court held that the claimant was an "employee" for Title VII purposes, because Merrill Lynch "exercised complete control over [the claimant's] work assignments, the means and manner of her performance, and the hours of her employment." *Id.* at 348. The court held that "[w]hen an employer has the right to control the means and manner of an individual's performance, . . . an employer-employee relationship is likely to exist." *Id.* It is worth noting that the court cited but apparently dispensed with any analysis under the hybrid test's eleven factors in reaching its result. *Id.* at 348 n.14. *Amarnare* clearly demonstrates a court's willingness to forego the application of the hybrid test factors where the employer's "right to control" the employee's work performance can be found.

[111] *See supra* notes 5, 6, 10-14, 21, 42, 53-56, 59-60 and accompanying text.

[112] *See supra* notes 1, 2, 7 and accompanying text.

[113] *See supra* notes 3-7, 16, 19-40, 46-47, 52, 58-110 and accompanying text.

[114] *See supra* notes 15, 19-20, 22-35, 38, 46-47, 62-110 and accompanying text.

[115] *See supra* notes 19-20, 22, 25-26, 38, 63, 65-73, 88-89, 93-97, 104-110 and accompanying text.

sures that the test is equitable to all parties.[116]

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[116] *See supra* notes 19, 21, 44, 49-50 and accompanying text.

AUGMENTING THE PUBLIC TRUST: THE SECRETARY OF STATE'S EFFORTS TO CREATE A PUBLIC TRUST ECOSYSTEM REGIME IN MISSISSIPPI

John Alton Duff [*]

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"It is declared to be the public policy of this state to favor the preservation of the natural state of the *public trust tidelands and their ecosystems*. . . ."[1]

I. INTRODUCTION

In 1988, the United States Supreme Court upheld a Mississippi Supreme Court decision and ruled that all lands subject to the ebb and flow of the tide in Mississippi belong to the state in trust for the benefit of its citizens.[2] The Supreme

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[1] MISS. CODE ANN. § 29-15-3 (1990) (enacted Mar. 31, 1989) (emphasis added).

[2] Phillips Petroleum Co. v. Mississippi, 484 U.S. 469 (1988).

Court applied the Public Trust Doctrine.[3] The doctrine is a recognition of the centuries old common law principle that certain territory and lands, such as the coastal waters and tidelands, represent such a unique resource belonging to all persons, that they are to be held in trust by a governing state for the benefit of its citizens and that portions of those lands can be alienated only in narrow circumstances.[4]

The high courts identified the type of property constituting the state's public trust corpus as well as the beneficiaries, but refrained from identifying precisely who, within the state government, should act as the trustee.[5] The courts also resisted offering any judicial insight into the precise method that ought to be employed in managing the assets of the public trust. In 1989, the Mississippi Legislature raised the specter of a landslide of litigation over title to thousands of acres of coastal property and passed legislation aimed at eliminating uncertainty over the ownership of much of the state's tidelands while clarifying ownership of coastal lands. This policy may have effectively depleted the property that comprises the state's public trust assets. In 1996, the Mississippi Secretary of State coordinated an effort to increase the acreage of the state's public trust lands by over 4,200 acres in exchange for less than seven acres of concrete filled shoreline area.[6] In doing so, he may have orchestrated one of the most unique and beneficial acts of public trust lands management ever seen in the United States.

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[3] *Phillips Petroleum*, 484 U.S. at 484-85.

[4] Martin v. Waddell, 41 U.S. (16 Pet.) 367 (1842); Illinois Central R.R. Co. v. Illinois, 146 U.S. 387 (1892). For a comprehensive overview of the Public Trust Doctrine, see Joseph L. Sax, *The Public Trust Doctrine in Natural Resource Law: Effective Judicial Intervention*, 68 MICH. L. REV 473 (1970).

[5] *See* Cinque Bambini Partnership v. State 491 So. 2d 508 (Miss. 1986), *aff'd sub nom.* Phillips Petroleum Co. v. Mississippi, 484 U.S. 469 (1988). The U.S. Supreme Court affirmed a Mississippi Supreme Court ruling that the state's public trust lands included tidelands reaching as far as the high water mark. *Phillips Petroleum*, 484 U.S. at 484-85.

[6] The lands included 4.03 acres of filled tidelands and 2.7 acres of unfilled tidelands which were scheduled to be filled for casino development. *See infra* section III.

This article reviews the legal principles embodied in the Public Trust Doctrine and the manner in which the doctrine has been applied in Mississippi. It pays particular attention to the Secretary of State's 1996 land exchange and concludes that the methods employed achieve the mandate of the trust as articulated by the legislature in the Public Trust Tidelands Act.[7] The land exchange stands to preserve the purpose, function, and value of the state's public trust lands.

Part II sets out the background of public trust doctrine principles in general. It follows public trust law from its origins in the Equal Footing Doctrine[8] and *Illinois Central Railroad Co. v. Illinois*,[9] to its recent application in Mississippi through *Phillips Petroleum Co. v. Mississippi*[10] and the Mississippi Public Trust Tidelands Act.[11] It evaluates the manner in which the public trust doctrine has been applied in Mississippi and introduces the private trust principles which apply to management of public trusts such as the Mississippi tidelands. Part III introduces the precedent-setting land exchange of public trust tidelands for upland wetlands. The exchange offers a unique picture of the Public Trust Doctrine at work to create a "new avenue" for adding new lands to a state's public trust. Part III also raises the questions which a "new avenue" creates, focusing on the authority of the Secretary of State to augment the public trust property pursuant to his authority as the designated manager of state lands.

Part IV is the heart of the article which offers rebuttal to the challenges raised in Part III. Specifically, Part IV explains the legal processes and mechanics employed by state trustees to accomplish a land exchange in light of the elements of the Public Trust Doctrine as well as the common law fiduciary duties of trusteeship. Part V concludes that the Mississippi land exchange is in the public interest, meets the requirements of the Public Trust Doctrine, and should be expressly recognized by the legislature as a valid and responsible transaction. The authors also add that future efforts to manage the state's public trust lands should be exercised with a higher degree of co-management between the branches of state government in order to secure augments to the state's trust lands.

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[7] MISS. CODE ANN. §§ 29-15-1 to -23 (1990).

[8] *See infra* note 16 and accompanying text.

[9] 146 U.S. 387 (1892).

[10] 484 U.S. 469 (1988).

[11] MISS. CODE ANN. §§ 29-15-1 to -23 (1990).

II. ORIGINS OF THE PUBLIC TRUST DOCTRINE

A. *Background of the Doctrine*

The Public Trust Doctrine arises from a body of law over 1,500 years old and has been called "one of the most important and far-reaching doctrines of American property law."[12] Black's Law Dictionary states that the doctrine "[p]rovides that submerged and submersible lands are preserved for public use in navigation, fishing and recreation[; the] state, as trustee for the people, bears responsibility of preserving and protecting the right of the public to the use of the waters for those purposes."[13] The common law doctrine currently employed in the United States developed in England as an express restriction on the right of the sovereign to divest those lands subject to the ebb and flow of the tide. Those lands were deemed to constitute an inalienable resource of the people.[14]

A handful of cases in the nineteenth century discussed the origin, rationale, and restraints embodied in the public trust doctrine. In 1842, in the case of *Martin v. Waddell's Lessee*, the Supreme Court acknowledged that during the formation of the United States as a republic, the thirteen original states retained title to the navigable waters and the shores subject only to limited federal servitudes.[15] Three years later, the Court noted that all subsequent states entering the union would do so on an "equal footing" with the original thirteen states and accordingly would take title to the tidelands and navigable waters within its borders.[16] This "equal footing" doctrine granted the states title and was extended to ensure that "new states . . . have the same rights as the original states in the tide waters, and in the lands below the high-water mark, within their respective jurisdictions."[17]

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[12] COASTAL STATES ORGANIZATION, INC. PUTTING THE PUBLIC TRUST DOCTRINE TO WORK xii (2d ed. 1997) [hereinafter PUTTING THE PUBLIC TRUST DOCTRINE TO WORK].

[13] BLACK'S LAW DICTIONARY 1232 (6th ed. 1990) (citing Oregon Shores Conservation Coalition v. Oregon Fish & Wildlife Comm'n, 662 P.2d 356, 364 (Or. Ct. App. 1983)).

[14] For an overview tracing the Public Trust Doctrine from the Magna Carta to contemporary application in Mississippi, see M. Casey Jarman, *Of Time, Tidelands, and Public Trust*, 57 MISS. L.J. 131, 131-33 (1987).

A landmark United States Supreme Court case, *Illinois Central Railroad Co. v. Illinois*, later clearly articulated the application of the Public Trust Doctrine to these lands.[18] Specifically, the Court stated that "[t]he doctrine is founded upon the necessity of preserving to the public the use of the navigable waters free from private interruption and encroachment. . . ."[19] *Illinois Central* also espoused the idea that those lands held in public trust may not be alienated the same as private lands held in trust. Instead, public trust land is "a title different in character from that which the state holds in lands intended for sale . . . . It is a title held in trust for the people of the state that they may enjoy the navigation of the waters, carry on commerce over them, and have liberty of fishing therein freed from the obstruction or interference of private parties."[20] The doctrine lay at rest for many years until a recent conflict in Mississippi resulted in the Supreme Court revisiting the doctrine and reinvigorating its principles.[21]

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[15] Martin v. Waddell's Lessee, 41 U.S. (Pet.) 367, 410 (1842).

[16] Pollard's Lessee v. Hagan, 44 U.S. (3 How.) 212 (1845) ("The manner in which the new states were to be admitted into the union, according to the ordinance of 1787 [Northwest Ordinance], as expressed therein, is as follows: '. . . such state shall be admitted by its delegates into the Congress of the United States, on an equal footing with the original states in all respects whatever.'" *Id.* at 222. *See also* 3 Stat. 472, 473 (1817).

[17] Shively v. Bowlby, 152 U.S. 1, 26 (1894).

[18] Illinois Central R.R. Co. v. Illinois, 146 U.S. 387, 452-53 (1892).

[19] *Id.* at 436. *See also* Kaiser Aetna v. United States, 444 U.S. 164, 183 (1979) (stating "geographical, chemical and environmental" qualities make lands beneath tidal waters unique) (Blackmun, J., dissenting); Shively v. Bowlby, 152 U.S. 1, 57 (1894) ("Lands under tide waters are incapable of cultivation or improvement in the manner of lands above high water mark."); United States v. 1.58 Acres of Land, 523 F. Supp. 120, 122-123 (D. Mass. 1981) ("For centuries, land below the low water mark has been recognized as having a peculiar nature, subject to varying degrees of public demand for rights of navigation, passage, portage, commerce, fishing, recreation, conservation and aesthetics. Historically, no developed western civilization has recognized absolute rights of private ownership in such land as a means of allocating this scarce and precious resource among the competing public demands. Though private ownership was permitted in the Dark Ages, neither Roman Law nor the English common law as it developed after the signing of the Magna Carta would permit it.").

B. Mississippi's Public Trust Principles

In 1810, President Madison proclaimed the portion of West Florida south of the 31st parallel as part of the United States.[22] In 1812, Congress authorized its annexation to the Mississippi Territory.[23] In 1817, the Mississippi Territory was admitted to the Union of the United States. Pursuant to the Equal Footing Doctrine, the state received title to thousands of acres of land subject to the ebb and flow of the tide. The Act of Congress authorizing Mississippi's admission to the Union specifically referred to this "equal footing" status,[24] as did the Act formally admitting the territory.[25]

In 1933, the Mississippi Supreme Court reflected upon tidelands and the purpose of the trust in the state and echoed the sentiments of the U.S. Supreme Court's earlier rulings: "The title of the state being held for public purposes, chief among which purposes is that of commerce and navigation."[26] The court also cited fishing as an inherent aspect of the public trust purpose.[27] Since that time, the state has expanded the recognized purposes to reflect "[t]he overall public interest and purpose accommodating an expanding population, commerce, tourism and recreation."[28] In a 1990 "case about a fishin' hole," the Mississippi Supreme Court waxed romantically for more than a dozen pages about the joys of piscatorial pursuit, and finally noted that "[f]ishing was prominent among the federal sovereign's public purposes" in withholding public trust lands from private ownership.[29]

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[20] *Illinois Central*, 146 U.S. at 452.

[21] PUTTING THE PUBLIC TRUST DOCTRINE TO WORK, *supra* note 12, at xiii.

[22] Cinque Bambini Partnership v. State, 491 So. 2d 508, 518 (Miss. 1986), *aff'd sub nom.* Phillips Petroleum Co. v. Mississippi, 484 U.S. 469 (1988) (citing THOMAS P. ABERNATHY, THE SOUTH IN THE NEW NATION 354 (1961); 1 RICHARD A. MCLEMORE, A HISTORY OF MISSISSIPPI, 226 (1973)).

[23] *See Cinque Bambini*, 491 So. 2d at 518 (citing 3 Stat. 472 (1812) and 2 Stat. 734 (1812)).

[24] 3 Stat. 348 (1817). The act of March 1, 1817 provided that Mississippi should be "admitted into the Union upon the same footing with the original states in all respects whatever."

[25] 3 Stat 472, 473 (1817). On December 10, 1817, Congress formally admitted Mississippi "into the union on an equal footing with the original states, in all respects whatever."

Years later, the Mississippi Supreme Court would have to reanalyze its application of the public trust doctrine in *Cinque Bambini Partnership v. State*.[30] The conflict was based on a dispute over rights to oil and gas on 600 acres of marshland in Hancock County, Mississippi.[31] For over 100 years, a succession of owners of the land had not paid property taxes to the state. In 1977, when the state granted a number of mineral leases throughout the area, the Cinque Bambini Partnership, a leaseholder to Mississippi tidelands, contended that the public trust doctrine extended only to submerged tidelands that are "navigable-in-fact."[32] The Mississippi Supreme Court, relying on the United States Supreme Court's analysis in *The Propeller Genesee Chief v. Fitzhugh*,[33] determined that the trust applies to both the navigable and non-navigable portions of a freshwater waterway up to the high-water mark.[34] The Mississippi Supreme Court then extended the trust to the state's border on the Gulf of Mexico.[35]

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[26] Rouse v. Saucier's Heirs, 146 So. 291, 291-92 (Miss. 1933).

[27] *See* Ryals v. Pigott, 580 So. 2d 1140, 1150 (Miss. 1990) (citing Rouse v. Saucier's Heirs, 146 So. 291 (Miss. 1933)).

[28] Treuting v. Bridge & Park Comm'n, 199 So. 2d 627, 633 (Miss. 1967). *See also Cinque Bambini*, 491 So. 2d at 512.

[29] Dycus v. Sillers, 557 So. 2d 486, 486-93 (Miss. 1990). The opinion is unique in its citation as much to works of literature as rules of law. The opinion cites, inter alia, Eudora Welty, Mark Twain, William Faulkner, Barry Hannah, John Grisham, Willie Morris, David Chapman Barry and a host of others. The literary analysis and application led the Chief Justice, Roy Noble Lee, to note in his concurrence, that "I have never attempted to edit the opinions of my colleagues on this Court. However, in my view, the first twelve pages of the majority opinion would best have been left unsaid, or relegated to a work of prose or fiction. The Bench and Bar have much law and many opinions to read and digest and should be permitted to choose when and where to read for pleasure." *Id.* at 508-09 (Lee, C.J., concurring).

[30] 491 So. 2d 508 (Miss. 1986), *aff'd sub nom.* Phillips Petroleum Co. v. Mississippi, 484 U.S. 469 (1988).

[31] *Cinque Bambini*, 491 So. 2d at 510. *See also* M. Casey Jarman, *Of Time, Tidelands, and Public Trust*, 57 MISS. L.J. 131, 134-35 (1987).

The appeal reached the Supreme Court under the title *Phillips Petroleum Co. v. Mississippi*, and the Court resolved the dispute in favor of the state, affirming that state public trust lands encompass all lands under navigable and non-navigable tidal waters below mean high tide.[36] Heralded as a way to resolve coastal boundary disputes, the effects of *Phillips Petroleum* were challenged by the Mississippi legislature in 1989 with the passage of the Mississippi Public Trust Tidelands Act directing the Secretary of State to delineate the public and private coastal land boundary in a manner inconsistent with the Supreme Court decision.[37] The Tidelands Act specifically declared Mississippi public policy to "favor the preservation of the natural state of the public trust tidelands and their ecosystems and to prevent the despoliation and destruction of them, except where a specific alteration of specific public trust tidelands would serve a higher public interest in compliance with the public purposes of the public trust in which the tidelands are held."[38] In addition, the legislation called for the resolution of uncertainty and disputes over tideland ownership and directed the Secretary of State to prepare a map of public trust tidelands.[39]

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[32] *Cinque Bambini*, 491 So. 2d at 513.

[33] 53 U.S. (12 How.) 443, 453 (1851).

[34] The Court held that admiralty jurisdiction encompassed navigable inland waters as well as those influenced by the tide, thereby expanding the boundaries of the public trust to include navigable inland waters. *Cinque Bambini*, 491 So. 2d at 514.

[35] *Id.*

[36] Phillips Petroleum Co. v. Mississippi, 484 U.S. 469, 476 (1988).

[37] MISS. CODE ANN. § 29-15-7 (1990). *See also* M. Casey Jarman & Richard McLaughlin, *A Higher Public Purpose? The Constitutionality of Mississippi's Public Trust Tidelands Legislation*, 11 MISS. C.L. REV. 5 (1990) [hereinafter Jarmon & McLaughlin].

[38] MISS. CODE ANN. § 29-15-3(1) (1990).

As with any property issue, a chief concern is the property line itself. After the *Phillips Petroleum* case, the state had to finally face the long latent problem of who owned what property. Over the course of the last ten years, the three branches of Mississippi's state government have been actively involved in the ultimate management of the state's public trust tidelands. In June of 1988, the Mississippi Secretary of State, prompted by the Supreme Court's decision, embarked on an effort to precisely define the boundary of the state's public trust lands pursuant to his authority as the designated manager of state public lands. He established the Blue Ribbon Commission on Public Trust Tidelands.[40]

The findings of the Commission led the Secretary to recommend that the state institute a comprehensive effort to determine, as best as possible, a boundary line that would reflect the reach of the state's tidally affected waters circa 1817, the date of Mississippi's admission to the union as a state.[41] This methodology, suggested the Secretary, would reflect the geographic scope and timing elements inherent in the Equal Footing and Public Trust Doctrines.[42]

The legislature, however, chose a more expedient method of demarcation, setting 1973 as the crucial point in time for boundary determination.[43] They chose that date as their baseline since it represented the date of enactment of the state's Coastal Wetlands Protection Act, the statute that set in motion the dispute over tidelands ownership and resulted in the state and federal supreme court decisions.[44] In doing so, lawmakers acknowledged that certain lands that might otherwise have been validly claimed as state property would effectively be conferred to owners who exhibited historic color of title. The trade-off was ostensibly made to benefit the citizens of the state by removing latent land claims as part of an effort to lend certainty and stability to a situation which would otherwise lead to a flood of litigation.[45] Having done so, the state may have effectively depleted the state's public trust lands by hundreds or thousands of acres in exchange for a regime of certainty, stability, and economic advancement. To do so, the legislature had to characterize the decision as constituting a "higher public purpose" in order to fit the narrow exception to the highly restrictive general rule that public trust lands cannot be alienated.[46]

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[39] MISS. CODE ANN. § 29-15-7(1) (1990).

[40] For an excellent overview of the role of the Blue Ribbon Commission and a chronology of events surrounding its activities, see Jarman & McLaughlin, *supra* note 37.

[41] *Id.* at 11-14.

[42] *Id.*

[43] *Id.*

[44] Mississippi Coastal Wetlands Protection Act, MISS. CODE ANN. §§ 49-27-1 to -69 (1997).

The Secretary of State challenged the Public Trust Tidelands legislation in court as a violation of the Mississippi Constitution which forbids the donation of public trust lands to private individuals.[47] The emerging litigation resulted in a Mississippi Supreme Court decision finding the Tidelands legislation in the public interest and clearly defining the state's responsibility when managing the public trust tidelands.[48] In *Secretary of State v. Wiesenberg*, the Mississippi Supreme Court stated that

> [t]he only way public trust lands can be disposed of is if it is done pursuant to 'a higher public purpose,' while at the same time not being detrimental to the general public. Once land is held by the state in trust, properties are committed to the

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[45] *Id. See also* MISS. CODE ANN. § 29-15-3 (1990).

[46] MISS. CODE ANN. § 29-15-3(2) (1990) (enacted in 1989).

> It is hereby declared to be a higher public purpose of this state and the public tidelands trust to resolve the uncertainty and disputes which have arisen as to the location of the boundary between the state's public trust tidelands and the upland property and to confirm the mean high water boundary line as determined by the Mississippi Supreme Court, the laws of this state and this chapter.

Id.

[47] MISS. CONST. art. 4, § 95.

[48] Secretary of State v. Wiesenberg, 633 So. 2d 983 (Miss. 1994).

> public (purpose) trust and may be alienated from the State only upon the authority of legislative enactment and then only consistent with the public purposes of the trust.[49]

Thus, the Mississippi Supreme Court stated that a permanent conveyance of public trust land is subject to a two-step process: (1) the conveyance is in furtherance of a higher public policy and (2) is subject to legislative enactment.[50] Therefore, no matter how compelling the public purpose may be, absent a decision by the Mississippi legislature, the Secretary cannot deplete the public trust corpus and convey public trust land to a private party. The Mississippi legislature, however, granted the Secretary an exception for lands which were substantially filled prior to enactment of the Coastal Wetlands Preservation Act of 1973.[51] Filled lands may be offered for sale without legislative enactment as long as the sale benefits the public trust.[52] Unfilled lands may be leased, but in order to sell them, the Secretary must follow the two-step process.[53]

The court recognized the many uses of public trust tidelands in Mississippi but examined the legislation in question to hold that the resolution of title disputes on the Mississippi coast did meet such a higher public purpose.[54] The court cited the legislative findings of fact in the Tidelands Act which stated that

> The Legislature finds that this [title] dispute has already caused extensive harm, is intolerable, and immediate resolution is required and would serve the higher public purpose, in order that public trust tidelands and submerged lands may be utilized through their normal interface with the fast lands in furtherance of all the usual purposes of the trust. The Legislature recognizes that it serves the interests of all the citizens

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[49] *Wiesenberg*, 633 So. 2d at 987.

[50] *Cinque Bambini*, 491 So. 2d at 513. The court repeated this process in *Secretary of State v. Wiesenberg*, 633 So. 2d 983 (Miss. 1994).

[51] *See* MISS. CODE ANN. § 29-15-7(1) (1990).

[52] MISS. CODE ANN. § 29-15-7 (Editor's Note).

[53] MISS. CODE ANN. § 29-15-3.

[54] *See Wiesenberg*, 633 So. 2d at 987.

> of the state as well as the interests of each individual area and that when controversies and problems arise between divergent interests it becomes the duty and responsibility of the Legislature to balance these interests. . . .[55]

While the litigation made its way to the Mississippi Supreme Court, the Mississippi legislature was busy passing new legislation legalizing riverboat gambling in Mississippi.[56] This greatly increased the value and activity on public trust tidelands in the Gulf. Casinos soon sprang up from barges sitting on leased public trust tidelands.[57] It is under this backdrop that the Secretary of State was approached by a casino wishing to buy rather than lease public trust tidelands for the operation of a casino and attendant entertainment facility and hotel.

III. THE MISSISSIPPI SECRETARY OF STATE'S 1996 PUBLIC TRUST LAND EXCHANGE

In 1996, the Mississippi Secretary of State embarked on a unique effort to increase the holdings of the state's public trust lands but raised many questions in the process. In 1996, the Mississippi Secretary of State's office transferred 6.73 acres of tidelands to a corporation in exchange for 4,225 acres of undisturbed habitat located in the three Mississippi coastal counties. The exchange is the first of its kind. By exchanging the Biloxi tidelands, the Secretary of State created a new avenue of transferring trust lands bypassing the requisite legislative enactment but has also forced review of the basic public trust doctrine principles and their application in Mississippi.

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[55] *Wiesenberg*, 633 So. 2d at 988 (quoting MISS. CODE ANN. § 29-15-1 (Editor's Note) (1990)).

[56] *See* MISS. CODE ANN. §§ 75-76-1 to -281 (1991).

[57] Numerous casinos have lease agreements with the Secretary of State, paying $500,000-$700,000 per year into the Public Trust Tidelands Fund which holds and disperses the revenue. In these instances, the Secretary determined that the trust gained more from leasing the lands than from leaving them in their previous state. E-mail correspondence with Jim Nelson, Assistant Secretary of State, Director of the Public Lands Division (Oct. 9, 1997) (on file with author).

A. *The Exchange*

Mirage Resorts planned a $500 million investment (known as Golden Nugget) including a floating casino, hotel, entertainment complex, and convention center.[58] Mirage approached the Secretary of State to purchase the tidelands rather than lease the lands which is common on the Mississippi gulf coast. The site contained three types of public trust tidelands. First, there were existing fastlands which had been filled between 1852 and 1942.[59] The Tidelands Act granted the Secretary of State the authority to negotiate boundary settlements on this type of property with the claimants. The Secretary negotiated a boundary agreement at today's mean high water line for monetary compensation of over $1.3 million.[60]

The second type of trust lands on the site were submerged lands which were planned to be filled. The Mississippi Department of Marine Resources and the U.S. Army Corps of Engineers had already given Mirage the permits to artificially fill approximately 2.7 acres in order to "square off" their parcel.[61] The Secretary of State reasoned that because the environmental agencies gave permission to fill those acres, they would take on the same character as the existing fastlands. Thus, the Secretary treated these acres the same as the filled tidelands. The Secretary's office admitted that an argument could be made that leasing the 2.7 acres would bring in more revenue in the long run.[62] But, the Secretary's office would then be responsible for managing 2.7 acres of public trust lands under concrete which was not a good option as the steward for the lands. In addition, the tidelands trust's primary objective is not revenue generation. Instead, the objective is preservation of the tidelands in their natural state. Because this 2.7 acres was lost to its natural state and would be forever, preservation was not an option.[63]

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[58] *Id.*

[59] U.S. Geological Survey Maps from 1852 did not show fill, but it did exist in aerial photography taken during World War II. *Id.*

[60] *Id.*

[61] This is typical because many of the old waterfront parcels are jagged and require smoothing out in order to provide for a clean, even docking of a casino vessel. *Id.*

[62] E-mail correspondence with Jim Nelson, Assistant Secretary of State, Director of the Public Lands Division (Oct. 9, 1997) (on file with author).

Mirage sought ownership of the 2.7 acres of adjacent unfilled land in order to provide an even line for smooth docking.[64] Originally, the Secretary directed Mirage to seek approval and enactment by the legislature.[65] The legislature had recessed for the summer and Mirage wanted a quicker alternative to the 2-step process.[66]

Clark analyzed the situation, acknowledging that because the DMR and the Corps granted the fill permits, the remaining 2.7 acres would soon be lost to the purpose of the public trust as filled lands.[67] In determining that a land swap exchange was the best alternative, Clark relied on the common law concept of an asset swap: trustees can exchange an old asset for a new asset as long as the new asset is of equal or greater value.[68]

Clark determined that swapping the 2.7 acres for other land of greater value would not be subject to the 2-step process involved in a permanent conveyance of public trust lands to a private party.[69] Mirage jumped at the chance to avoid the time-consuming legislative enactment and to generate positive publicity about the company's dedication to environmental preservation.[70]

On May 6, 1996, the Chancery Court of Harrison County ruled that Clark, as trustee, has the authority to exchange the lands.[71] The Chancery Court stated that

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[63] Mr. Nelson argues that by exchanging these filled and to-be-filled lands, Mississippi better preserves the other tidelands and better preserves the public interest inherent in the public trust doctrine. Telephone Interview with Jim Nelson, Assistant Secretary of State, Director of Public Lands Division (Dec. 10, 1997).

[64] *Id.*

[65] *Id.*

[66] *Id.*

[67] E-mail correspondence with Jim Nelson, Assistant Secretary of State, Director of the Public Lands Division (Oct. 9, 1997) (on file with author).

[68] *Id.*

[69] *Id.*

[70] *Historic Environmental Land Exchange Announced*, COAST BUSINESS, (Gulfport), July 29, 1996, at 9.

> in order to effectively and properly manage the public trust and to discharge his duties as trustee, the Secretary of State has determined that an exchange of property as described below is in the public interest, promotes the public trust and serves the purposes for which the public trust exists.[72]

The court concluded that such an exchange was within the power of the Secretary as trustee and "authorized and empowered [the Secretary] to exchange Parcel A for the Exchange Property and to execute all documents and to do all things necessary to consummate this exchange of property."[73]

Even with court approval, Clark recommended that Mirage seek legislative ratification by approaching the Legislature after it reconvened.[74] While Mirage declined to petition the Legislature for after-the-fact approval, Clark's office notified the Mississippi legislature of the exchange.[75] He wrote letters to all the members of the coast delegation which included the President Pro Tem of the Senate; talked personally with Tim Ford, Speaker of the House; and invited the coast legislators to participate in the press conference announcing the exchange. Seven of them appeared and spoke.[76] The legislature convened for a session and neither ratified nor declined the land exchange.[77] While these activities do not rise to the level of a specific legislative enactment authorizing a "conveyance," the Secretary of State contends that the notice provided to the legislature, the nature of a net-gain transaction, and the legislature's silence on the matter amount to a tacit consent of a legitimate act by the Secretary in his role as manager of state lands.[78]

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[71] The Secretary sought court approval of the proposed act in advance of taking action. In the Matter of the Stewardship of the Public Trust Tidelands, Secretary of State Eric Clark, Trustee, C 2402 96-498 (Harrison Co. Chancery Court, May 6, 1996).

[72] *Id.* at 3.

[73] *Id.* at 5-6.

[74] E-mail correspondence with Jim Nelson, Assistant Secretary of State, Director of the Public Lands Division (Oct. 9, 1997) (on file with author).

[75] E-mail correspondence with Jim Nelson, Assistant Secretary of State, Director of the Public Lands Division (Dec. 10, 1997) (on file with author).

[76] *Id.*

[77] *Id.*

The third type of trust lands indirectly involved were submerged lands adjacent to the 2.7 acres that were the subject of the land exchange. They represent current submerged lands where the Mirage casino barge will be docked. They are public trust tidelands and remain so. The Secretary will negotiate a lease for these lands in the range of $500,000 and $700,000 each year.[79]

B. The New Public Trust Lands

The exchange itself involved a number of different government agencies. The Mississippi Department of Marine Resources and the Mississippi Secretary of State signed a Memorandum of Understanding setting out the objectives each agency sought under the exchange. The two agencies agreed to develop a Coastal Preserves Strategic Plan, a priority acquisition program and specific management plans for the preserved areas.[80] The Secretary of State agreed to assist the Department of Marine Resources in securing additional properties for the preserve system, coordinating preserve projects, and restoring and enhancing projects.[81]

In addition, the Secretary of State entered into the Articles of Dedication with the Mississippi Commission on Wildlife, Fisheries and Parks. The Articles referenced the Natural Heritage Law[82] that allows dedication of a natural area preserve, noting the court approval and Secretary's trustee position as appropriate authority.[83] Specifically, the Articles state that

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[78] E-mail correspondence with Jim Nelson, Assistant Secretary of State, Director of the Public Lands Division (Oct. 9, 1997) (on file with author). Mirage counts on this legislative silence as ratification since their ability to get title insurance on the property depends upon their valid receipt of title.

[79] *Id.*

[80] MEMORANDUM OF UNDERSTANDING BETWEEN MISSISSIPPI SECRETARY OF STATE AND MISSISSIPPI DEPARTMENT OF MARINE RESOURCES, 1.

[81] *Id.* at 2. Other duties include biological surveys, environmental assessments, land use, land cover, and management maps, selected public access improvements, emergency response plans, public relations and education, and the securing of federal, state, local or private matching funds for preserve projects.

[82] MISS. CODE ANN. §§ 49-5-141 to -157 (1997).

> [t]he property is perpetually dedicated for the purposes set forth in the Natural Heritage Law, to be held in trust for present and future generations of Mississippi, more specifically, as a natural area preserve to be maintained in its present condition, subject to other provisions of these Articles of Dedication, for the public purposes of hunting, fishing and other outdoor recreational activities, scientific research, education, nature study, aesthetic enjoyment and providing habitat for plant and animal life and communities and protection for natural objects.[84]

Even with this intergovernmental cooperation, the exchange leaves questions behind. In the exchange, the trust gave up 6.73 acres of legal tidelands. It gained governance over 4,225 acres of uplands adjacent to tidelands, but did not gain any actual tidelands. In order to manage the new lands as public trust lands, the Secretary had the deeds and articles of dedication include language that the property is to be treated as public trust tidelands.[85] While the 4,225 acres are not actually tidelands, they will be governed by the same rules as the tidelands. This legal characterization of the lands as public trust tidelands is reasonable in light of the fact that the lands transacted away had only legal, and not actual, tideland characteristics, functions, and values.

Thus, the trust lost legally characterized "tidelands" without gaining any—disposal without enactment. It is worth noting that over 4 acres of the "tidelands" had already been filled with concrete while the remaining 2.7 acres were authorized to be filled. As a result, while they could be labeled "tidelands" by law, their physical characteristics were those of developed upland areas. In the exchange of lands, the two sets of lands were treated as the same, but their legal character was different.

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[83] ARTICLES OF DEDICATION BETWEEN MISSISSIPPI SECRETARY OF STATE AND MISSISSIPPI COMMISSION ON WILDLIFE, FISHERIES AND PARKS 1 (1996).

[84] *Id.* at 2.

[85] *Id.* at 1-2.

The 6.73 are tidelands; the 4,225 are uplands, some with wetland characteristics. The Harrison County Chancery court noted the importance of the land by explaining, "these lands are some of the most environmentally sensitive, pristine natural areas of the Mississippi Gulf Coast. [P]ortions of these lands are marshes which serve as nursery and spawning grounds for commercial and recreational fishing. [T]hese lands are also important areas for marine, aquatic and avian habitat."[86]

However, should the acquired lands be considered public trust lands in light of the fact that they are upland, rather than tideland in character? Historically, the public trust lands have been bound by the reach of the sea. The question has been raised as to whether the public trust doctrine is of such an amphibious nature that it can "move" easily from the water onto the shore lands."[87] Mississippi has indicated as much in that the legislature has expressed its intention to include in the purpose of the public trust, the "preservation of the . . . tidelands *and their ecosystems*."[88] Also, the fact that a small area of filled tidelands were exchanged for what amounted to a thousands of acres of uplands contiguous to tidelands in their natural state supports the transfer.

While the proposed "swap" would be the first to constitute a model for acquiring new public trust lands of the nature of the public trust doctrine, the concept of swapping non-public-trust state trust lands is at least twelve years old. The process is gaining popular acceptance. Utah has executed a number of land swaps involving non-public-trust state trust lands.[89] New

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[86] In the Matter of the Stewardship of the Public Trust Tidelands, Secretary of State Eric Clark, Trustee C 2402 96-498 at 4 (Harrison Co. Chancery Court, Second Judicial District, May 6, 1996).

[87] Scott W. Reed, *The Public Trust Doctrine: Is it Amphibious?*, 1 J. ENVTL. L. & LITIG. 107, 107 (1986).

[88] MISS. CODE ANN. § 29-15-3 (1990) (emphasis added).

[89] *See* Western States Land Comm'rs Ass'n, *Utah Completes First in a Series of Important Land Trades* (visited Apr. 4, 1998) <http://www.wslca.org/ newsletter/current/utah.html>.

> In an exchanged completed on August 30, 1997, the State of Utah School and Institutional Trust Lands Administration traded 120 acres of

Mexico has also benefitted from such land swaps.[90]

C. *Questions the Exchange Raises*

The exchange raises questions of law as well as principles of public trust administration embodied in the state constitution, legislation, case law, and administrative precedent, particularly over the course of the last ten years. It also highlights the role of the state's three branches of government in executing the state's public trust duties. Basic questions vital to the analysis of the exchange include:

What is the purpose of the trust?

> trust land north of St. George for 200 acres of Bureau of Land Management (BLM) land in Summit and Salt Lake Counties. . . . This is the first of a series of trades planned under a Memorandum of Understanding between the Utah Trust Lands Administration and the United States Bureau of Land Management Under [sic] the memorandum, the Trust Land Administration and Bureau of Land Management will work together to exchange approximately 10,000 acres of trust lands located in the desert tortoise critical habitat near St. George for yet to be determined federal public lands.

Id.

[90] Western States Land Comm's Ass'n, *New Mexico, BLM Swap Land, Raise School Revenues* (visited Apr. 4, 1998) <http://www.wslca.org/newsletter/winter_97/nm_blm.html>.

> The state of New Mexico and the Bureau of Land Management have officially exchanged deeds for nearly 100,000 acres of land in Socorro and Catron counties. This transaction, completed in August, brought to a close more than a year of consultation and negotiation between the parties and is expected to lead to future land exchanges. "This puts the state land trust in a better position to generate revenues for our schoolchildren," said New Mexico State Land Commissioner Ray Powell. "And in terms of our management of wildlife and flora, this is the right thing to do." The checkerboard pattern of current state and federal land ownership in Socorro and Catron counties includes prime New Mexico habitat areas for elk and bighorn sheep. The land exchange opens former state lands to public access for hunting, hiking and other recreational uses. . . . Another goal of this and future exchanges is to consolidate holdings of Isolated tracts of land. Benefits to the public include more logical ownership boundaries for three special management areas, two areas of critical environmental concern and four wilderness study areas.

Id.

> Who are the beneficiaries?
>
> What is the nature and extent of the State's ownership, i.e., what is the dividing line between the upland property capable of being privately owned and the state-owned tidelands?
>
> Who is the trustee?
>
> What substantive and procedural restraints and conditions exist regarding alienation and did the Secretary of State follow these when completing the land exchange?

Given the fact that the state has owned and controlled its public trust lands since its statehood admission in 1817, it may seem unusual that these questions have not been comprehensively answered at some point over the course of the nineteenth or twentieth centuries. As noted below, some states have faced similar instances where these questions arose only after decades.[91]

While cases on attempts to alienate public trust land are abundant in the United States, an express endeavor to increase a state's public trust corpus is a relatively new concept. In effect, the Secretary exchanged 6.73 acres of filled and soon-to-be-filled tidelands in a commercial area for what amounted to a 4,200 acre package of uplands contiguous to tidelands in much more pristine and natural areas. The transaction serves to augment the amount of land in the state's public trust corpus in an effort to better secure and preserve the state's public trust tidelands and their ecosystems.

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[91] *See, e.g.*, Hughes v. State, 410 P.2d 20, 22 (Wash. 1966) (quoting oral opinion of trial court), *rev'd*, 389 U.S. 290 (1967). "It is a rather interesting circumstance to me that this being 1964, it is about 75 years since statehood and that our State Supreme Court would not have been called upon specifically and directly to decide the [public trust doctrine] questions involved here." *Hughes*, 410 P.2d at 22.

IV. CHALLENGING TRADITIONAL TRUST PRINCIPLES

Basic trust principles provide that the three necessary elements of a private trust are: 1) a *corpus* which constitutes the body of trust property; 2) a defined class of beneficiaries for whom the trust is to be administered; and 3) a trustee who acts as the legal titleholder of the trust property and who has a legally binding fiduciary duty to the beneficiaries to administer the trust.[92] This section answers the questions set out above by examining the land exchange through the traditional parts of the trust: the trustee, the beneficiaries, and the corpus. These three subsections conclude that the land exchange meets the requirements of a traditional trust while embodying the public interest purposes which should be inherent in public trust principles.

A. *Who is the Trustee over Public Lands?*

In Mississippi, the question of who is the trustee merits attention in light of the interest public trust lands have garnered since 1988. The value of minerals below state-owned tidelands is considerable, as evidenced by the dispute in the *Phillips Petroleum* case.[93] And the value of the tidelands themselves constitutes an enormous economic benefit representing millions of dollars since dockside gaming was legalized in 1991.[94]

Jurisdiction over the state's tidelands seems to have shifted like the tide itself over time.[95] In 1938, the Mississippi Supreme Court held that jurisdiction over the state's tidelands regarding an action to recover for the removal of sand and gravel resided in the Attorney General, rather than the state land commissioner.[96] The court indicated that the Attorney General, pursuant to his statutory and common law authority to protect the rights of the public and to represent the state as sovereign, was best suited to take at least some role in the trusteeship of the state's public trust lands.[97] The state legislature had delegated general supervisory powers over state lands to the state land commissioner in 1892.[98] The duties of the state land commissioner were transferred to the Office of the Secretary of State on January 1, 1980.[99] These duties included record keeping and day-to-day administration of trust lands.[100]

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[92] RESTATEMENT (SECOND) OF TRUSTS § 2 cmt. h (1959).

[93] Phillips Petroleum Co. v. Mississippi, 484 U.S. 469, 472 (1988).

[94] *See* MISS. CODE ANN. §§ 75-76-1 to -313 (Supp. 1997); MISS. CODE ANN. § 97-33-1 (1994).

[95] Control over the three types of Mississippi trust lands have seen numerous changes since statehood. Mississippi contains three types of public lands subject to the public trust doctrine: tidelands, submerged lands, and sixteenth section lands. The Mississippi Legislature passed its first sixteenth section land statute in 1818. The Legislature set aside one sixteenth to benefit state public schools. While the initial legislation placed the authority to lease sixteenth section lands in the hands of county judges, actual control of the lands changed hands until Reconstruction when the legislature passed a statute which allowed for the sale of

1. The Trustee: the Legislature

While the courts note time and time again that the state acts as the trustee, the particular branch or officeholder is often overlooked, taken for granted or ignored.[101] Commentators and courts focus on the trustee role of state legislatures, indicating that the primary responsibility and authority are assumed to reside in the legislative branch while administrative duties and authority may be delegated to other state officials or

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sixteenth section lands. This statute was repealed in 1878. LEGISLATIVE AUDIT COMMITTEE, SPECIAL REPORT ON SIXTEENTH SECTION LAND MANAGEMENT 8-10 (1977).

Finally, in 1890, the Constitutional Convention enacted Section 211 to govern sixteenth section lands forbidding the sale but laying out conditions of leases of such lands. *Id.* at 10.

Submerged lands are subject to private ownership but sixteenth section lands are not. Because of their unique value to the state, the sale of tidelands are limited as well.

[96] State *ex rel.* Rice v. Stewart, 184 Miss. 202, 222 (1938).

[97] *Id.*

[98] MISS. CODE ANN. § 7-11-1 (1991) (repealed 1978). *See also* Turney v. Marion County Bd. of Educ., 481 So. 2d 770, 776 (Miss. 1985).

[99] MISS. CODE ANN. § 7-11-2 (1991).

[100] MISS. CODE ANN. § 7-11-2 to -25 (1991).

[101] *See generally* PUTTING THE PUBLIC TRUST DOCTRINE TO WORK, *supra* note 12, at 329.

agencies.[102]

While United States Supreme Court decisions have focused on the role of the legislatures regarding attempts to alienate public trust lands, those opinions do not establish a rule that the trustee role lies solely in any state's legislative branch. State courts have similarly given their attention to the role of legislatures in ruling on public trust issues.

For example, the Vermont Supreme Court noted, "[e]very *legislature* must at the time of its existence, exercise the power of the State in the execution of the trust devolved upon it."[103] In California, the state high court opined that the

> state in its proper administration of the trust may find it necessary or advisable to cut off certain tidelands from water access and render them useless for trust purposes. In such a case *the state through the Legislature* may find and determine that such lands are no longer useful for trust purposes and free them from the trust. When tidelands have been so freed from the trust—and if they are not subject to the constitutional prohibition forbidding alienation—they may be irrevocably conveyed into absolute private ownership.[104]

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[102] *Id.* at 330. *See generally* Pennsylvania Gas and Water Co. v. Kassab, 322 A.2d 775 (Pa. 1974); State v. Cozzens, 2 R.I. 561, 563-65 (1850); Orion Corp. v. State, 747 P.2d 1062, 1071-73 (Wash. 1987).

[103] State v. Central Vermont Ry., Inc., 571 A.2d 1128, 1132-33 (Vt. 1989) (emphasis added). *See also* Donna Sheehan Fitzgerald, Note, *Extending Public Trust Duties to Vermont's Agencies: A Logical Interpretation of the Common Law Public Trust Doctrine*, 19 VT. L. REV. 509, 514-31 (1995) (regarding delegation of public trust responsibilities from legislature to state agencies with case law from California and Vermont).

> When the public trust doctrine was first articulated by colonial courts, the trustee role was imposed solely on the legislature because the Legislature was the only body of government at that time that granted title to private persons. In today's more complex administrative state, however, state agencies are usually the governmental bodies that allocate rights to trust property. Meanwhile, the Legislature's role in allocating rights and granting title to use State property is much more limited than the Agency's, because the Legislature only authorizes the Agency to take the role that the Legislature once performed.

Id. at 523-24 (citing VT. STAT. ANN. tit. 29, § 403 (1984); VT. STAT. ANN. tit. 10, § 1263a (Supp. 1994)).

[104] Marks v. Whitney, 491 P.2d 374, 380 (Cal. 1971) (quoting City of Long

In a later case, the California Supreme Court reviewed the source of law governing the designated trustee's responsibilities and indicated that the legislature was not the exclusive authority in acting as the trustee.[105] In *National Audubon Society v. Superior Court*, the court ruled (1) that the common law public trust doctrine and the administrative scheme operated in tandem, leaving the agency with public trust duties that were imposed by common law; and (2) that under common law, the governmental agency was responsible for fulfilling public trust duties despite the absence of an express legislative delegation of such duties.[106]

Individual state constitutions may indicate what property is governed by the public trust doctrine as well as who holds the role or how the responsibility is shared among the branches of state government as trustee.[107] Washington state's eleventh hour drafting of a constitutional provision governing the ownership of tidelands is a notable example.[108] The Washington

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Beach v. Mansell, 476 P.2d 423, 437 (1970)) (emphasis added).

[105] National Audubon Soc'y v. Superior Court, 658 P.2d 709; 718-27 (Cal. 1983).

[106] *National Audubon Soc'y*, 658 P.2d at 732.

[107] *See, e.g.,* PA. CONST. art. 1, § 27 ("The people have a right to clean air, pure water and to the preservation of the natural, scenic, historic, and esthetic values of the environment. Pennsylvania's public natural resources are the common property of all the people, including generations yet to come. As trustee of these resources, the Commonwealth shall conserve and maintain them for the benefit of all the people."); MICH. CONST. art. 4, § 52 ("The conservation and development of the natural resources of the state are hereby declared to be of paramount public concern in the interest of the health, safety and general welfare of the people. The legislature shall provide for the protection of the air, water and other resources of the state from pollution, impairment and destruction.").

[108] WASH. CONST. art. XVII, § 1.

> Tidelands.
> Section 1. Declaration of State Ownership. The state of Washington asserts its ownership to the beds and shores of all navigable waters in the state up to and including the line of ordinary high tide, in waters where the tide ebbs and flows, and up to and including the line of ordinary high water within the banks of all navigable rivers and lakes: *Provided*, that this section shall not be construed so as to debar any person from asserting his claim to vested rights in the courts of the state.

Id. See also Hughes v. Washington, 410 P.2d 20, 23 (Wash. 1966).

Constitution makes ambiguous reference to the scope, extent and authority governing the application of the public trust tidelands in that state, a fact Washington's Supreme Court recognized as deliberate procrastination.[109] Referring to the provision governing public trust lands and the constitutional convention from which it arose, the court noted that while Article 17 of the Washington Constitution "asserts state ownership of tidelands and disclaims all right to tidelands theretofore patented by the United States," it makes no declaration of policy to govern the use or disposition of such lands.[110] The convention, explained the court, *"left the use and sale of state-owned tidelands to the politics of future legislatures and to the interpretation to be given Article 17 by the Supreme Court."*[111] The ruling offers some insight into the reasoning behind the postponement, noting that the issue of tidelands ownership dominated the state constitutional convention debates.[112]

> It was not until August 22, 1889, the final day of the convention, that Article 17 (quoted *supra*) was adopted. The article is, in truth, a Janus-like compromise of the contentions of the various schools of thought in the constitutional convention. Although it asserts state ownership of tidelands and disclaims all right to tidelands theretofore patented by the United States, it makes no declaration of policy to govern the use or disposition of such lands.

Hughes, 410 P.2d at 23.

[109] *Id.*

[110] *Id.*

[111] *Id.* (emphasis added).

[112] *Id.*

> One cannot read the record of the proceedings of the state constitutional convention . . . without concluding, as do the historians of that period, that the most vexing and politically sensitive problem confronting the convention was that of harbors, and the control, use, ownership, and disposal of the tidelands of the new state to be. No other problem was of more vital concern to the economic development of the state, for the tidelands in front of Seattle and other cities on Puget Sound and the ocean were of tremendous value.
>
> During the convention suggested constitutional proposals ranged from a declaration of inalienable state ownership of tidelands with limited leasing privileges, to no declaration at all, thus leaving all questions of tideland ownership and use to the whim of future legislatures. The major source of difference arose from whether the state, the cities, or private individuals and corporations should control the water front. . . .

2. *Sub-units of Government as Trustee*

In some instances, sub-units of government also have been delegated trustee responsibilities over certain state trust lands. In New Jersey, a court ruled that where a city is the trustee of public lands that have been settled by the public and not by a private individual, the state legislature has the authority to alter the trust's purpose."[113]

Similarly, the high court in New York has recognized the trustee status of cities regarding the administration of public trust lands and the duty of care owed to the beneficiaries. In referring to the restraint on alienation inherent in the public trust doctrine, the court ruled that "where the city subsequently conveyed, to a private owner, certain "upland abutting upon land under water," described as "bounded by the Hudson river," with no words indicating any "intent to convey the lands under water," it must be presumed that the city in its exercise of sovereign power as a municipality "intended only to have included in the conveyance the uplands to high-water mark, retaining the tideway and lands under water *as trustee of the public domain*, in the interests of commerce and of the state."[114]

3. *Trustee of Public Lands in Mississippi*

In Mississippi, the legislature had given general supervisory power over the state's public trust lands to the state land commissioner. However, the office of state land commissioner was abolished January 1, 1980.[115] Today, pursuant to the 1980 consolidation of state land management authority, the Secretary of State has charge of all state public lands.[116]

> The conflict of interests was sharp and the debates reported were acrimonious.

Hughes, 410 P.2d at 23 (footnote omitted).

[113] Newark v. Stockton, 14 A. 630, 637 (N.J. 1888).

[114] *In re* Riverside Park, 75 N.E. 156, 156-58 (N.Y. 1905) (emphasis added).

[115] MISS. CODE ANN. § 7-11-2 (1990).

[116] MISS. CODE ANN. § 7-11-11 (1990).

> The secretary of state shall have charge of the swamp and the over-

Those duties include acting as the state's designated signatory authority in instances of purchase or conveyance of state lands.[117]

The delegation of authority to the Secretary of State does not necessarily amount to any abdication of trustee authority by the state as a whole or by the legislature in part. A 1985 decision infers the ultimate authority of the legislature as a principal, or *the* principal, trustee.[118] "The state official responsible for Mississippi's public lands is *presently* the Secretary of State."[119] This statement indicates that the court distinguishes between the state as trustee and the Secretary as the delegated administrator. The court's temporal qualification suggests that as the administrator, the Secretary serves at the pleasure of the legislature. This is not unusual considering that significant state school trust lands are effectively administered by municipal school districts.[120]

The statutory description of the Secretary of State's duties regarding state public lands lends support to the proposition that the legislature may have intended the Secretary to play a significant and almost exclusive role in the management of public trust lands. The responsibility that the Secretary held in drawing the preliminary public trust tidelands map further

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> flowed lands and indemnity lands in lieu thereof, the internal improvement lands, the lands forfeited to the state for nonpayment of taxes after the time allowed by law for redemption shall have expired, and of all other public lands belonging to or under the control of the state. The regulation, sale and disposition of all such lands shall be made through the secretary of state's office.

§ 7-11-11.

[117] *Id.* "The secretary of state shall sign all conveyances and leases of any and all state-owned lands and shall record same in a book kept in his office for such purposes." *Id.*

[118] *See* Turney v. Marion County Bd. of Educ., 481 So. 2d 770, 776-77 (Miss. 1985).

[119] *Id.* at 776 (emphasis added).

[120] *Id.* at 777. "The State, as trustee, may not divest itself of its duties. However, the State, by statute, may vest in others the authority to do acts which the trustee cannot practicably be expected to perform. [For example, the] State manages its sixteenth section trust property through local county boards of education." *Id.* (citing RESTATEMENT (SECOND) OF TRUSTS § 171 (1959)).

supports this notion.[121] It is likely that these vestments of authority have led the Secretary on occasion to claim that in his official capacity, he is *the* trustee of the state public trust lands.[122]

However, other statutes indicate that the trustee role is a shared duty and does not reside exclusively in any one office or branch of the state government.[123] The very statute that conveys signatory authority to the secretary does not endow him with sole or even discretionary authority to do so. The caselaw qualifies the Secretary's role as it notes, "[T]he Secretary of State, *under the general direction of the Governor* and as authorized by law, shall sell and convey the public lands *in the manner and on the terms provided herein*."[124] The court in *Secretary of State v. Wiesenberg* likened the Office of Secretary of State to "a tool in the implementation of the [Public Trust Tidelands] Act."[125]

B. Who are the Beneficiaries & What is the Purpose of the Trust?

1. The Beneficiaries

It is well recognized that the citizens are the class of beneficiaries for whom the public trust is to be administered.[126] Thus, the beneficiaries of the Mississippi public trust include all the citizens of the state.[127]

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[121] *See* MISS. CODE ANN. §§ 29-1-1, 29-15-7, 29-15-9 (1990 & Supp. 1997).

[122] *Mississippi Statewide Live* (television broadcast no. 97122, Aug. 29, 1997).

[123] For example, Mississippi Code section 29-15-5 refers to the "state's responsibility as trustee" rather than referring to the Secretary. MISS. CODE ANN. § 29-15-5 (1990).

[124] MISS. CODE ANN. § 29-1-1 (Supp. 1997) (emphasis added).

[125] Secretary of State v. Wiesenberg, 633 So. 2d 983, 997 (Miss. 1994). The reference being to that provision of the Act governing the preliminary drafting of a tidelands boundary map, rather than a ruling on the Secretary's complete extent of authority under the Act.

[126] *See* PUTTING THE PUBLIC TRUST DOCTRINE TO WORK, *supra* note 12, at 170.

[127] MISS. CODE ANN. § 29-15-1 (Editor's Note) (1990).

2. *Public Trust Purpose*

Historically, the purposes of the public trust lands were to secure a common right to fishing, navigation and commerce. The Mississippi Supreme Court acknowledged the metamorphosis of public trust purposes over time at the outset of their 1986 *Cinque Bambini* ruling:

> Over the years those purposes have come to include navigation and transportation, commerce, fishing, bathing, swimming and other recreational activities development of mineral resources, environmental protection and preservation . . . the enhancement of aquatic, avarian and marine life, sea agriculture and no doubt others . . . . Suffice it to say that the purposes of the trust have evolved with the needs and sensitivities of the people-and the capacity of trust properties to serve those needs.[128]

The nature of the public trust lands had been at issue in numerous cases since Mississippi gained statehood and the state courts had long held the land that made up the trust assets were those subject to the ebb and flow of the tide.[129] Accordingly, state ownership was subject to a dividing line between the upland property which was capable of being privately owned and the state-owned tideland.[130]

The extent of ownership of Mississippi tidelands was the general issue that faced the court in the *Phillips Petroleum* case, wherein the court adopted the ebb and flow test in conjunction with the floating toothpick navigability test.[131] Accordingly, the court ruled that any lands subjacent to the ebb and flow of the tides constituted public trust lands, held for the citizens of the state under the state's ownership.[132] While the well-established rule is that the trust lands were those that existed at the date of statehood, Mississippi has fixed its boundary determination date as 1973, the date of the passage of the Coastal Wetlands Protection Act.[133]

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[128] Cinque Bambini Partnership v. State, 491 So. 2d 508, 512 (Miss. 1986) (citations omitted). "The public purposes to which these lands . . . may be devoted are not static." *Cinque Bambini*, 491 So. 2d at 512.

[129] Parks v. Simpson, 137 So. 2d 136, 139 (Miss. 1962).

> This Court, by an unbroken line of decisions over 100 years, has declared that the State 'is the owner of lands in the beds of all its shores, inlets, and adjacent to the islands, over which the tides of the sea ebb and flow, and that it holds title as trustee for the people of the State.'

Id. (citations omitted).

[130] *See* MISS. CODE ANN. § 29-15-1 (Editor's Note) (1990).

[131] Phillips Petroleum Co. v. Mississippi, 484 U.S. 469, 469 (1988).

3. *Public Trust Doctrine Principles Evolving into an Ecosystem Approach*

In Mississippi, the doctrine has long included the hallmark trio of purposes: fishing, navigation and commerce. It has long been recognized that the scope of the doctrine is evolving to meet the evolving needs of humans and to integrate sound scientific and land management methodology. The Mississippi Supreme Court acknowledged the functional evolution by recognizing that "[t]he public purposes to which these lands and waters placed in the public trust . . . are not static."[134]

The evolution of the doctrine is not limited to that of function but also to reach. Similar to simplified illustrations used in describing evolution theory, the public trust doctrine seems to be creeping out of the water onto dry land. This makes sense since added protection to the upland areas of a tidelands ecosystem better secure the original as well as ancillary purposes of the trust. In burgeoning societies where populations are shifting to coastal areas to live, work, and vacation, it is quite rational to afford, as the Mississippi Legislature has called for, an ecosystem approach to protecting the very heart of the public trust corpus by strengthening the skeleton and muscles that surround it. An increasing number of legal scholars and commentators are reflecting on the role of the public trust doctrine as an ecosystem protection principle.[135]

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[132] *Phillips Petroleum*, 484 U.S. at 416.

[133] MISS. CODE ANN. § 29-15-7 (1990). *See* Coastal Wetlands Protection Act, MISS. CODE ANN. §§ 49-27-1 to -69 (1981). *See also* Secretary of State v. Wiesenberg, 633 So. 2d 983 (Miss. 1994). In the interest of clearing title to lands along the Mississippi gulf coast, the legislature passed the Tidelands Act, naming 1973 the date used to determine a fixed boundary between public and private lands.

[134] *Cinque Bambini*, 491 So. 2d at 512.

This evolution poses interesting legal questions in light of the fact that an evolving and expanding public trust doctrine will eventually overlap with other legal principles. In states that employ the prior appropriations doctrine as their basic water law scheme, the evolving public trust doctrine is increasingly deemed an influencing, and sometimes overriding, factor. In California, water diversion as a property right has effectively been limited by the application of the public trust doctrine.[136] A supreme court ruling in that state interpreted the public trust doctrine to constitute a paramount regime governing not only the historically accepted public trust resources, but also those resources that amount to integrated elements of the public trust ecosystem.[137]

In *Marks v. Whitney*, the California Supreme Court used the public trust doctrine to protect state tidelands.[138] The court emphasized that because the doctrine was expanding to encompass changing public needs, the state should make use of this expansion to provide for the protection of California tidelands. Specifically, the court recognized that "one of the most important public uses of the tidelands . . . is the preservation of those lands in their natural state, so that they may serve as ecological units for scientific study, as open space, and as environments which provide food and habitat for birds and marine life, and which favorably affect the scenery and climate of the area."[139]

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[135] *See* Michael C. Blumm & Thea Schwartz, *Mono Lake and the Evolving Public Trust in Western Water*, 37 ARIZ. L. REV. 701 (1995); Matthew Thor Kirsch, Note, *Upholding the Public Trust Doctrine in State Constitutions*, 47 DUKE L.J. 1169 (1997); Alison Rieser, *Property Rights and Ecosystem Management in U.S. Fisheries: Contracting for the Commons?*, 24 ECOLOGY L.Q. 813 (1997); James P. Karp, *A Private Property Duty of Stewardship: Changing our Land Ethic*, 23 ENVT. L. 735 (1993).

[136] National Audubon Soc'y v. Superior Court, 658 P.2d 709, 732 (Cal. 1983).

[137] National Audubon Soc'y v. Superior Court, 658 P.2d 709 (Cal. 1983) (reasoning that minimum in stream flow of water and even "air purity" of area ought to be considered in protecting public trust resources); Marks v. Whitney, 491 P.2d 374 (Cal. 1971). *See generally* Harry R. Bader, *Antaeus and the Public Trust Doctrine: A New Approach to Substantive Environmental Protection in the Common Law*, 19 B.C. ENVT'L AFF. L. REV. 749, 750 (1992); Michael D. Morrison & M. Keith Dollahite, *The Public Trust Doctrine: Insuring the Needs of Texas Bays and Estuaries*, 37 BAYLOR L. REV. 365, 376 (1985).

[138] Marks v. Whitney, 491 P.2d 374 (Cal. 1971).

Twelve years later, in *National Audubon Society v. Superior Court*, the California Supreme Court interpreted the public trust doctrine's jurisdiction to include the air, water and wildlife.[140] One commentator noted that while that ruling constituted a new legal benchmark regarding the reach of the public trust doctrine, "the doctrine's promise remained largely inchoate and its message largely inarticulate" for a more than a decade.[141] Another interpreted the inference as articulate enough, reading the ruling as standing "for the proposition that the public trust doctrine is capable of reaching out and encompassing the ecological values of an entire ecosystem."[142] California's state water board has been steadily building upon that 1983 ruling, to increasingly consider "air quality within the ambit of trust consideration"[143] and other western states have joined the ecosystem approach, as well.[144]

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[139] *Marks*, 491 P.2d at 380.

[140] *National Audubon Soc'y*, 658 P.2d at 709. *See also* Anna R. C. Caspersen, *The Public Trust Doctrine & The Impossibility of "Takings" by Wildlife*, 23 B.C. ENVTL. AFF. L. REV. 357, 375 (1996).

[141] Gregory S. Weber, *Articulating the Public Trust: Text, Near-Text, and Context*, 27 ARIZ. ST. L.J. 1155, 1156 (1995).

[142] Z. PLATER, ET AL, ENVIRONMENTAL LAW AND POLICY: NATURE, LAW AND SOCIETY at 391 (1992).

[143] Weber, *supra* note 140, at 1191 (citing California State Water Resources Bd., Water Right Decision D-1631 (Sept. 28, 1994)).

[144] *See* United Plainsmen Ass'n v. North Dakota Water Conservation Comm'n, 247 N.W.2d 457 (N.D. 1976) (stating one decade before the *National Audubon* decision, that state has public trust duty to evaluate prospective major water diversion for their short and long-term environmental effects); and Orion Corp. v. Washington, 747 P.2d 1062, 1073 (Wash. 1987) (determining that public trust doctrine extended beyond navigational and commercial fishing rights to include recreational purposes on Washington tidelands). *See also* Kootenai Environmental Alliance, Inc. v. Panhandle Yacht Club, Inc., 671 P.2d 1085 (Idaho 1983) (interpreting trust doctrine to require state to do comprehensive environmental review of proposed development affecting public trust uses). *But see* Lisa Lombardi, *The Public Trust Doctrine in Idaho*, 33 IDAHO L. REV. 231 (1996) (discussing ramifications of recently enacted legislation to undercut ecosystem approach).

4. *Mississippi's Public Trust Doctrine Ecosystem Provision*

The Mississippi Legislature, in a moment of ecological prescience, seems to have expressly enacted a concept that had heretofore been crystallizing through the judicial and administrative process in California and elsewhere: that the public trust doctrine is an ecosystem concept. In 1989, state lawmakers determined that "[i]t is declared to be the public policy of this state to favor the preservation of the natural state of the public trust tidelands *and their ecosystems.*"[145] Teamed with traditional public trust principles, the Mississippi Legislature created a powerful tool in conserving the state's public lands and gives support to the Secretary of State's land exchange because the exchange best carries out this objective.

Mississippi is not alone in combining public trust principles with a state statute aimed at ecosystem management. The Supreme Court of Washington decided in favor of the ecosystem approach by teaming the public trust doctrine with a state statute. In *Portage Bay-Roanoke Park Community Council v. Shorelines Hearings Board*, the court recognized that trust principles are reflected in the Shoreline Management Act's underlying policy which contemplates "protecting against adverse effects to the public health, the land and its vegetation and wildlife, and the waters of the state and their aquatic life, while protecting generally public rights of navigation and corollary rights incidental thereto."[146]

The Mississippi Legislature, in passing the Tidelands Act, paved the way towards augmenting the traditional public trust principles that have traditionally protected navigation, fishing, and commerce, in an effort to protect and preserve those functions through ecosystem conservation principles. The Secretary of State is the first to act on this merging of principles in Mississippi. The land exchange represents a reasonable, and perhaps mandated, manifestation of the legislature's intent.

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[145] MISS. CODE ANN. § 29-15-3 (1990) (enacted March 31, 1989) (emphasis added).

[146] Portage Bay-Roanoke Park Community Council v. Shorelines Hearings Bd., 593 P.2d 151, 153 (Wash. 1979). *See also* Michael L. Wolz, *Applications of the Public Trust Doctrine to Protection and Preservation of Wetlands: Can it Fill the Statutory Gaps?*, 6 BYU J. PUB. L. 475, 494 (1992).

C. What is the Corpus of the Trust and the Restrictions on Alienation?

Private trusts include a critical fourth element which actually serves to create the other three: a settler or originator. The settler of a trust dictates its terms and articulates its purpose. The settler names the trustees, identifies the beneficiaries and makes the originating contribution to establish the corpus of the trust.

Critics of the public trust doctrine as a legal trust principle point to its lack of a settler as a fatal deficiency. With no identifiable originator, they claim, the purposes, property, beneficiaries, and trustees are the result of mere speculation or conjuring under the rubric of natural law theory.[147] Those who recognize the public trust as a legitimate legal trust note that the corpus, purpose, beneficiaries and trustees are well-established pursuant to centuries of common law. And they do not rule out the existence of a settler.[148]

Admittedly, the lack of a settler distinguishes the public trust from a private trust. When it comes to the Public Trust Doctrine, the method of determining the elements of the trust is complicated by the fact that this particular type of trust derives from a set of legal concepts dating back to the Institutes of Justinian, articulated again in the Magna Carta, and even cited in epic poems.[149]

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[147] *See* James L. Huffman, *A Fish Out of Water: The Public Trust Doctrine in a Constitutional Democracy*, 19 ENVTL. L. 527 (1989).

[148] PLATER ET AL., *supra* note 141, at 375 (noting that identity of originator "depends on your theological inclinations").

[149] BEOWULF, PROLOGUE:

> So Hrothgar decided
> he would build a mead-hall,
> the greatest the world had
> ever seen, or even imagined.

Adopted from centuries of legal precedent and deemed applicable to the individual U.S. states, the laws governing a public trust have been defined for the most part in an ad hoc common law manner. The chief characteristic of public trust land is its inalienability.

1. *Inalienability of Public Trust Property*

In a capitalist society that touts property ownership as an inalienable right, the concept of land that cannot be alienated may seem anathema in the United States. While some commentators indicate that the philosophy upon which the public trust doctrine is formulated merits a rule of "strict inalienability,"[150] others suggest that the public trust doctrine ought to focus on the protection and maintenance of the functions embodied in the doctrine's purpose rather than the status of the owner and the level of alienability of the property.[151] Professor Bader proposes a doctrine that would not bar private use and development of trust property, so long as the prospective developer could show that such use would not disrupt the function of the property.[152] The method of public trust administration would allow courts to apply a standard wherein the doctrine is recognized as allowing development, but applying protective measures to ensure that the areas and their role were not detrimentally impacted by human use and develop-

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> There he would share out
> to young and old alike
> all that God gave him
> *except for public lands* and men's lives.

Id. (emphasis added).

[150] John Moustakas, *Group Rights in Cultural Property: Justifying Strict Inalienability*, 74 CORNELL L. REV. 1179, 1218 (1989). Moustaka suggests that the public trust doctrine constitutes "the most important theoretical basis for advocating a regime of strict inalienability." *Id.*

[151] Harry R. Bader, *Antaeus and the Public Trust Doctrine: A New Approach to Substantive Environmental Protection in the Common Law*, 19 B.C. ENVTL. AFF. L. REV. 749, 759 (1992).

[152] *Id.*

ment.[153]

The inalienability prescription embodied in the doctrine harkens back to a time when the sovereign controlled all within his reach. He could grant away lands to reward faithful soldiers, to forge alliances within the kingdom or with other states. However, the doctrine restricted even the sovereign's power to alienate those special lands. A distinction arose between the jus privatum (private rights) which the sovereign could grant away and the jus publicum (public rights) which he was duty bound to maintain for the benefit of the people.[154]

One might consider the concept of property alienability as running along a spectrum rather than as a yes or no dichotomy. The current application of the doctrine indicates that there are acceptable, albeit narrow, circumstances to the general rule of inalienability. As such, a better characterization of the current regime is that a strict scrutiny regarding alienation exists rather than a rule of strict inalienability. Sovereigns have always had some measure of discretion in divesting themselves of portions of public trust property pursuant to highly stringent protective conditions.[155] The current application of the public trust doctrine places navigable waters and tidelands at the far end of the alienability spectrum opposite from unfettered freely alienable property. That is, the public trust lands have a high presumption of inalienability.[156]

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[153] *Id.*

[154] *See* PUTTING THE PUBLIC TRUST DOCTRINE TO WORK, *supra* note 12, at 6.

[155] *See* Joseph L. Sax, *Liberating the Public Trust From Its Historical Shackles*, 14 U.C. DAVIS L. REV 185 (1980).

[156] James L. Huffman, *A Fish Out of Water: The Public Trust Doctrine in a Constitutional Democracy*, 19 ENVTL. L. 527, 562 (1989) (noting navigable waters and submerged lands are subject to public's easement for navigation and fishing); Mark Cheung, Comment, *Dockominiums: An Expansion of Riparian Rights That Violates the Public Trust Doctrine*, 16 B.C. ENVTL. AFF. L. REV. 821, 830 (1989) ("In essence certain public lands and waters are 'inalienable'") (citing A. REITZE, ENVIRONMENTAL LAW 5-32 (2d ed. 1972)); Joseph L. Sax, Comment, *Why We Will Not (Should Not) Sell the Public Lands: Changing Conceptions of Private Property*, 1983 UTAH L. REV. 313 (1983).

While some free-market advocates might blanch at the thought of the inefficiencies derived from these "locked up" assets, some analysts of law and economics acknowledge that certain restrictions on the alienability of property may increase efficiency, a primary objective of market economics.[157] Further, certain non-economic ideals such as citizenship and distributive justice may be ill-served by market ideals and better served by alienability restrictions.[158]

In the United States, the landmark case regarding the restraint on alienation of public trust lands is *Illinois Central Railroad v. Illinois*, wherein the Supreme Court first articulated the rationale for retaining public trust lands and each state's duty to manage them in perpetuity for the benefit of its citizens.[159] "It is a title held in trust for the people of the state that they may enjoy the navigation of the waters, carry on commerce over them, and have liberty of fishing therein freed from the obstruction or interference of private parties."[160] The Court noted that the state, as sovereign over those lands and their functions, could not abdicate its role as trustee.[161]

The Court succinctly stated the rule as well as the exception regarding alienation of any part of the public trust: "the control of the state for the purposes of the trust can never be lost, except as to such parcels as are used in promoting the interests of the public therein, or can be disposed of without any substantial impairment of the public interest in the lands or water remaining."[162]

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[157] *See* Susan Rose-Ackerman, *Inalienability and the Theory of Property Rights*, 85 COLUM. L. REV. 931 (1985).

[158] *Id.*

[159] Illinois Central R.R. Co. v. Illinois, 146 U.S. 387, 452-53 (1892).

> It is the settled law of this country that the ownership of and dominion and sovereignty over lands covered by tide waters, within the limits of the several States, belong to the respective States within which they are found, with the consequent right to use or dispose of any portion thereof, when that can be done without substantial impairment of the interest of the public.

Id. at 435.

[160] *Id.*

[161] *Id.*

In *Illinois Central* and its progeny extending to *Phillips Petroleum Co.*, the Supreme Court acknowledged that the doctrine, while applicable to all states, was still subject to each individual state's interpretation, so long as that interpretation does not violate the core concepts of the doctrine.[163] The Court found neither a need nor a justification for establishing a uniform application of the doctrine.[164] As a result, the role of trustee of the public trust lands and the recognized trust purposes in any given state may vary to some degree.

Courts have held that the substantive principles governing public trust land administration prohibit the alienation of all or substantial portions of a state's trust lands. Even minor portions of the trust lands are prohibited from being alienated without a determination that such disposal constitutes some "higher public purposes" or procedural conditions which govern the steps that should be taken in any effort to dispose of public trust lands. In Mississippi, the state constitution, statutes, and case law provide varying degrees of instruction on the process. The Secretary of State acts as the day-to-day manager in charge of state lands and must act as the signatory in any purchase or conveyance of public lands.[165] He is required to do so, "under the general direction of the Governor," in instances of purchase and conveyance of public lands.[166] Further, any conveyance is subject to the authorization of the state Legislature pursuant to a specific legislative enactment.[167]

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[162] *Id.*

[163] Phillips Petroleum Co.v. Mississippi, 484 U.S. 469, 481 (1988). "[T]here is no universal and uniform law upon the subject . . . [rather] each state has dealt with the lands under the tide waters within its borders according to its own views of justice and policy." *Id.* (quoting Shively v. Bowlby, 152 U.S. 1, 26 (1894)).

[164] *Id.* "No reason to disturb the 'general proposition [that] the law of real property is, under our constitution, left to the individual states to develop and administer." Hughes v. Washington, 399 U.S. 290, 295 (1967) (Stewart, J. concurring).

[165] MISS. CODE ANN. §§ 7-11-4, -11, (1991); MISS. CODE ANN. § 29-1-1 (1990).

[166] MISS. CODE ANN. § 29-1-1 (1990).

2. Public Trust Lands in Mississippi

While the basic elements of the public trust in Mississippi are known, the detail and specificity ordinarily embodied in a declaration of trust are not. As noted above, and recognized by the courts, the corpus includes the navigable waters and the tidelands within the state. The beneficiaries are the citizens of the state and the trustee is the state itself. However, that level of definition is not sufficient to guide the day-to-day management of the state's public trust lands.

Accordingly, courts faced with assessing detailed legal issues regarding the public trust have turned to the principles of private trusts to gain some insight. Mississippi courts have long held that the legal principles of private trusts are applicable to the state's public lands held in trust for the citizens of the state.[168] Mississippi case law dictates that the common law duties of a trustee of a private trust are equally applicable to the state in its capacity as trustee of state trust lands, noting that "one who holds as trustee is prohibited from giving away, appropriating to his own use, or otherwise, disposing of the corpus of a trust in derogation of the rights of the beneficiaries."[169]

Similar to the private trust trustee, the trustee of public lands has a "duty to manage the trust corpus" in a way that "reasonably maximize[s]" its benefits.[170] Based on the principles embodied in the state constitution and increasingly in legislative enactments, the Mississippi Supreme Court has distinguished the duty as a proprietor of state lands from the duty as a trustee of public trust lands, characterizing the state's duty as a trustee even "more concrete" regarding lands held in trust for a specific purpose.[171]

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[167] *Id.*

[168] Hill v. Thompson, 564 So. 2d 1, 6 (Miss. 1989). Common law rules enforceable in the case of private trusts are applied to the public school lands trust. *Hill*, 564 So. 2d at 6. The Mississippi courts have long equated public school land trusts with public trust lands. *Id. See* Keys v. Carter, 318 So. 2d 862, 864 (Miss. 1975); Holmes v. Jones, 318 So. 2d 865, 868 (Miss. 1975).

[169] *Hill*, 564 So. 2d at 6. The *Hill* court stated that "[t]his rule applies to the school lands trust." *Id.* (citing Tally v. Board of Supervisors, 323 So. 2d 547, 550 (Miss. 1975)); *see Holmes*, 318 So. 2d at 868-69; State v. Weiss, 706 P.2d 681, 683 (Alaska 1985); State v. University of Alaska, 624 P.2d 807, 813 (Alaska 1981).

[170] *Hill*, 564 So. 2d at 6 (citing RESTATEMENT (SECOND) OF TRUSTS, § 181

Article 4 of the Mississippi Constitution restricts the process and circumstances governing the alienation of state public lands. Section 90(u) requires that any legislative enactment which alienates state public lands must do so via the general laws and not via the special or local lawmaking process.[172] Section 95 prohibits the State from donating state land to private individuals and corporations and requires that any sale of land to a corporation or association be at a price not less than that which would be offered by a private individual.[173]

In light of the statutory standard that all conveyances "must be by legislative enactment," two questions arise. First, was the exchange by the Secretary of State the type of conveyance referred to in the statute? And, second, if the exchange was a conveyance and an alienation of trust property, is the exchange automatically void or merely voidable?

3. Conveyance v. Alienation

Was there a "conveyance?" If the Tidelands Act of 1989, and its resulting "settlement" policy of refusing to contest certain tidelands as state-owned, did not amount to a "donation," then it could be argued that the trustee's "exchange" was not a convey-

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(1959)).

[171] Hill v. Thompson, 564 So. 2d 1, 7 (Miss. 1989). While this case addressed school trust lands, the principle is arguably as valid for public trust tidelands.

[172] MISS. CONST. art. 4, § 90(u). This section states, in pertinent part:

> The legislature shall not pass local, private, or special laws in any of the following enumerated cases, but such matters shall be provided for only by general laws, viz: . . . . Granting any lands under control of the state to any person or corporation.

Id.

[173] MISS. CONST. art. 4, § 95.

ance.

The Secretary of State's reliance on his common law authority as a trustee to effect an asset swap that did not amount to a conveyance may trouble some advocates of procedural purity. It could be argued that any transfer, even one that is undisputedly advantageous, amounts to a conveyance that requires a legislative enactment. However, if one likens the exchange to a mere exchange of fungible goods, the resulting analysis is that no conveyance occurred, since the State as transferor obtained like goods in return. However, it is admitted that the uniqueness of real property does not lend itself to the categorization of fungibility.

If the statutory reference to conveyance referred to a diminution in trust property, there is no conveyance, since the Secretary's actions substantially increased the acreage of the state's trust assets. In light of the fact that the Legislature and the Mississippi Supreme Court have noted that diminution of the trust, by effectively conferring private property rights to certain portions of it, did not amount to an improper "donation" of trust assets, it reasonably follows that any arrangement that increases the size, degree, function and benefit of the trust corpus should not be considered a conveyance.

At worst, the transaction should be considered an unperfected arrangement subject only to a timely expression of invalidity by the Legislature. The executive branch through the Secretary and the Governor authorized the exchange, and if the State as trustee can be recognized as a three-headed trustee, it remains in the hands of the Legislature to either confirm or deny the validity of the transaction.

D. Is the Exchange Void or Voidable?

To those who would argue that the transaction amounts to a "conveyance," this transaction could be in derogation of the statute that deems any attempted conveyance, without a specific legislative enactment, as void. However, even if the transaction amounts to a "conveyance," the effect of a missing legislative enactment may render the transaction voidable rather than void.

The Secretary of State indicates that the land exchange should not be characterized as a conveyance, but rather as an "asset swap." Even if the exchange is read as a conveyance in part, the status of such an alienation of state land must be reviewed within the framework of the Secretary's authority and the legitimacy of the transaction. Well-settled principles show that a legislative enactment is not a *sine qua non* for public land transactions, regardless of their merit, leaving the legislature's role one of ultimate guardian over such transactions. Because courts have found that legislatures use "void" when a contract or action should actually be "voidable," should the transaction at hand be found merely "voidable," rather than void ab initio?

1. *Breathing "Voidable" into "Void"*

Strict constructionists could argue that the term "void" represents an intention by the legislature that any transaction involving state public trust lands must have a prior specific legislative enactment to be deemed valid. Otherwise, the transaction should be deemed a legal nullity incapable of being ratified or validated by subsequent action. However, the interpretation of "void" as "voidable" is a subject of ongoing arguments in federal and state courts around the United States, including the courts in Mississippi. *Black's Law Dictionary*, a source that many jurists consult when looking for the "plain meaning" of statutory terms, illustrates the problem. It states that "[t]he word 'void' is used in statutes in the sense of utterly void so as to be incapable of ratification, and also in the sense of voidable . . . ."[174]

Having acknowledged the ambiguity of what might otherwise seem a straightforward term, *Black's Law Dictionary* points out what courts have long prescribed, that "resort must be had to the rules of construction in many cases to determine in which sense the Legislature intended to use it."[175] *Black's* authors adopt an analysis employed by the courts: "An act or contract neither wrong in itself nor against public policy, which has been declared void by statute for the protection or benefit of a certain party, or class of parties, is *voidable* only."[176]

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[174] BLACK'S LAW DICTIONARY 1573 (6th ed. 1990).

In *Westerlund v. Black Bear Mining Co.*, the Eighth Circuit Court of Appeals refused to take a strict view of the legislature's use of "void."[177] It stated:

> Courts take judicial cognizance of the fact that Legislatures use the word 'void' in statutes in the sense of utterly void so as to be incapable of ratification, and in the sense of voidable by those alone whose rights are infringed without express discrimination, so that resort must be had to settled rules for the interpretation of statutes in each case to determine in which sense the Legislature intended to use it.[178]

Admittedly, some courts are hesitant to construe the term "void" as anything other than void ab initio.[179] The *Westerlund* court, however, declared that legislatures may not mean void in every circumstance when writing a statute.[180] This leaves the court to make a policy decision in determining whether a contract or action should be deemed void as if it never occurred, or determined voidable and given some definition.

The question in *Westerlund* was whether a bill by stockholders of a corporation to set aside a lease executed by the directors without the consent of the stockholders, was founded on rights which may properly be asserted by the corporation.[181] A Colorado law prohibited directors or trustees of a manufacturing company from encumbering a plant until the question had been submitted at a legal meeting of the stockholders and a majority of all the shares of stock had been voted in favor of the proposition.[182]

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[175] *Id.* at 1573-74.

[176] *Id.* at 1574.

[177] Westerlund v. Black Bear Mining Co., 203 F. 599, 611 (8th Cir. 1913).

[178] *Westerlund,* 203 F. at 611.

[179] *See* Hirschfeld v. McKinley, 78 F.2d 124, 131 (9th Cir. 1935) (holding issuance of stock void where insufficient consideration was tendered).

[180] *Westerlund,* 203 F. at 607.

[181] *Id.* at 603-04.

> In speaking for the Eighth Circuit, Judge Sanburn held that a contract of a corporation, within its corporate powers, and neither wrong in itself nor against public policy, but defective from a failure to observe in its execution the requirement of a law enacted for the protection of third parties, is voidable only, although the Legislature had said that such a contract was "absolutely void."[183]

He held that the lease in question was capable of ratification by estoppel; that it was valid until avoided, not void until validated.[184] In that case, the rights of a corporation were at issue; no question was raised in regard to the rights of creditors nor of receivers.[185]

When deciding whether a contract or action is void or voidable, a court must rely on the rule that:

> [A]n act declared to be void by statute which is *malum in se* or against public policy is utterly void and incapable of ratification, but an act or contract so declared void, which is neither wrong in itself nor against public policy, but which has been declared void for the protection or benefit of a certain party, or class of parties, is voidable only and is capable of ratification by the acts or silence of the beneficiary or beneficiaries.[186]

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[182] *Id.*

[183] *Id.* at 612-13.

[184] *Id.* at 613.

[185] *See Westerlund*, 203 F. at 613.

[186] *Id.* at 611 (citations omitted). A gift of goods declared by statute to be void as to creditors is voidable only, may be avoided by them alone, and is susceptible to ratification. *Id.* A Massachusetts federal district court also noted that an act is void

> when the consideration or purpose or act was *malum in se*, as murder, for instance, or *malum prohibitum*, as an offence, because both are prohibited on account of the community at large. . . . Thus, on the principle already stated, that some acts may be void as to some persons and purposes, but not others, such acts are regarded as usually only void-

The First Circuit also addressed the 'scope of authority principle' that is assessed in determining where certain actions may be deemed void rather than merely voidable. The court stated:

> Another principle of law so firmly established as to be no longer debatable is that an act or contract of a corporation which is beyond the scope of its corporate powers, an act that it cannot lawfully do in any way or manner under any circumstances, is incapable of ratification by estoppel or otherwise, and the corporation itself may challenge it. But an act or contract of a corporation which is within its general corporate powers, which is neither wrong in itself nor against public policy, but which is defective from a failure to observe in its execution a requirement of law enacted for the benefit or protection of a third party or parties, is voidable only. Such an act or contract is valid until avoided, not void until validated, and it is subject to ratification and estoppel.[187]

If one equates the citizens of the state, represented by their respective legislators, with the stockholders of a corporation represented by a board of directors, a United States Supreme Court case should also apply. In addressing an Illinois statute "which declared a lease without the consent of the stockholders void," the Supreme Court stated:

> Although this statute, in terms, declares that any such lease, made without the written consent of the Illinois stockholders, 'shall be null and void,' it would seem to have been enacted for the protection of such stockholders alone, and intended to be availed of by them only.[188]

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able.

Tufts v. Tufts, 24 F. Cas. 288, 289 (C.C.D. Mass. 1847) (No. 14,233).

[187] *Westerlund*, 203 F. at 612 (citations omitted).

[188] *Id.* at 614-15; St. Louis, Vandalia & Terre Haute R.R. Co. v. Terre Haute & Indianapolis R.R. Co., 145 U.S. 393, 403 (1892). Where a corporate bankruptcy trustee attempted to defend his title against a mortgage made by the corporation without the required statutory consent of the stockholders, the United States Second Circuit Court of Appeals stated:

> We have not overlooked the point made by the trustee that the mortgage was invalid because the consents of the stockholders of the mort-

Westerlund built upon this analysis by holding the lease in question voidable because the "incumbering of the property of the corporation was not malum in se, that it was not against public policy, and that the provision of the statute which withheld from the board of directors the power to incumber, without the approving vote of the stockholders, was enacted for their sole benefit. . . ."[189]

Such is the weight of reason and authority in support of the position that the stockholders alone had the right, and that the corporation was without right, to maintain a suit to avoid this lease on the ground that it was made without the approving vote of its stockholders. Thus, the courts have concluded that a lease in such circumstances is valid until avoided, not void until validated and is capable of ratification by estoppel.[190]

2. *The Mississippi Supreme Court Construes "Void"*

The Mississippi Supreme Court has also ruled that transactions that fail to meet the statutorily and constitutionally guaranteed public trust purposes should be considered voidable at the option of the state as trustee rather that void ab initio.[191] In *Hill v. Thompson*, the Mississippi Supreme Court at-

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> gagor had not been filed in the office of the proper official, as required by the provisions of the stock corporation law. These provisions are for the protection of stockholders, and only stockholders can take advantage of any defects in complying with them.

In re New York Econ. Printing Co., 110 F. 514, 519 (2d Cir. 1901). In a similar case, Judge Marshall, delivering the unanimous opinion of the Wisconsin Supreme Court, stated that "[s]uch statutes as the one under consideration by the great weight of authority are regarded as having been enacted for the protection of stockholders. Neither the corporation nor any one representing it, nor its creditors can efficiently invoke the statute against an executed contract. . . ." Eastman v. Parkinson, 113 N.W. 649, 652 (Wis. 1907). *See generally* GEORGE T. BOGERT, TRUSTS §§ 153-160 (6th ed. 1987) (discussing remedies of trust beneficiaries).

[189] *Westerlund*, 203 F. at 612 (citations omitted).

[190] *See id.* at 615.

[191] *See* Hill v. Thompson, 564 So. 2d 1, 26-27 (Miss. 1989) (Hawkins, P. J., dissenting).

tempted to close the "vast gulf between *void* and *voidable*."[192] The court asserted that common law rules which are enforceable in the case of private trusts are applied to public school lands trusts.[193] In deciding that a lease of public school trust lands for ninety-nine years at a nominal cost was a donation of public trust lands and a violation of the Mississippi Constitution, the court used its own precedent to declare "where consideration paid for a lease . . . is so small as to amount to a donation of the property, the lease is void."[194] But the court construed its own decision to mean that the lease in question was voidable rather than void and could be declared void by a court of competent jurisdiction.[195]

The court applied the Hill rationale two years later in *Board of Education v. Hudson*.[196] Specifically, it found that a ninety-nine year lease of 3.5 acres at $150 a year was an unconstitutional donation and thus "*voidable* at the option of the school board."[197] However, in its own words, the court found the lease voidable and void in the same opinion.[198] Ultimately, the lease must have been considered voidable because, while the leasehold was declared void, the case was remanded to the School Board for a new determination of the market value of the leasehold while "Hudson shall remain in possession of the leasehold and have the right of first refusal."[199] In both cases, Justice Hawkins dissented and called the court's attention to the difference between void and voidable.[200]

The dissents point out numerous holes in the court's rationale, but Mississippi's willingness to read "void" as "voidable," and vice versa, finds allies in the Eighth and First Circuits. Under the rationales of these courts, the conveyance between the Secretary of State and Mirage Resorts remains voidable rather than void. This bolsters the public trust, of course, because it reinforces the land exchange as voidable, and still in tact, maintaining the trust's recent acquisition of pristine habitat. The distinction does, however, encourage the legislature, private citizens interested in such exchanges, and the Secretary of State's office to better meet the statutory requirements so that an exchange does not become subject to the void/voidable rationale of the Mississippi Supreme Court and the logic of Justice Hawkins' dissenting arguments. Even if the land exchange were challenged, the Mississippi Supreme Court has set precedent that it will act in a policy-friendly way when determining whether an action be void or merely voidable. The land exchange would likely survive such an analysis.

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[192] *Hill*, 564 So. 2d at 26.

[193] *Id.* at 27.

[194] *Id.* at 9. (quoting Talley v. Board of Supervisors, 323 So. 2d 547, 550.

[195] *Id.*

[196] Board of Educ. v. Hudson, 585 So. 2d 683, 686 (Miss. 1991).

[197] *Hudson*, 585 So. 2d at 687 (emphasis added).

[198] *Id.* at 684, 687. The court held that the lease in question was void. *Id.* at 684. The court said that "voluminous law" on the subject led it to hold that the lease was "an unconstitutional donation" and "*voidable* at the option of the school board." *Id.* at 687 (emphasis added).

[199] *Id.* at 688.

[200] *See Hudson*, 585 So. 2d at 692 (Hawkins, P.J., dissenting) (noting majority's inconsistent use of "void" and "voidable").

V. CONCLUSION

The Secretary of State's Office called the exchange a "win-win" situation by citing several reasons that Mississippi gained.[201] First, the original 6.73 acres were in the middle of developed casino district in Biloxi.[202] The 4,225 acres were pristine habit, adding the southeast quarter of Hancock County to the trust.[203] The new acreage can now act as a buffer zone for coastal development and moves the trust into the more natural areas of the state. Second, the acreage was filled, not contributing to the purpose of the tidelands trust. Finally, Mississippi got the Mirage investment of $500 million, the largest private investment in the history of Mississippi.[204]

Further, the recent actions of the Secretary of State illustrate that in his capacity as one member of the state-as-trustee group, his office represents the most vigilant trustee in upholding the stated "ecosystem" protection provisions of the trust and accordingly the fiduciary duties owed to the beneficiaries.[205]

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[201] Telephone Interview with Jim Nelson, Assistant Secretary of State, Director of Public Lands Division (December 10, 1997).

[202] *Id.*

[203] *Id.*

[204] *Id.*

The Mississippi Constitution, statutes, and court rulings, read in their totality, indicate that the Trustee of the state's public trust lands is the state government as a whole and not any one individual or even one branch. Rather, the duties are shared and the responsibility is a collaborative one. The legislative and executive branches have responsibility to take affirmative steps to ensure that the trust is managed pursuant to their fiduciary duty to the citizens as beneficiaries. The judicial branch remains available to resolve disputes between the two branches where they arise, and to make declarations of law.

The legislature has confirmed this concept time and again by conferring upon the Secretary of State, the role of co-trustee responsible for the day to day administration of the trust and the role as signatory to any acquisition, conveyance, or exchanges of title to public lands.

At the same time, the legislature, through its law-making process, and the judiciary, though its rulings, have established the fact that the authority of the Secretary of State as a trustee is subject to certain limitations. That is, the Secretary has the authority and discretion to play a significant role in the management of the trust, but certain actions must be executed with the express approval of the legislature.

It is clear that the Secretary of State cannot deplete the corpus of the trust. Any conveyance which would diminish the trust is subject to procedural as well as substantive conditions. The procedural aspect requires a specific legislative enactment.

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[205] Most recently, the Office of the Secretary of State has doggedly pursued individuals and corporations who attempted to refrain from paying full market value for tidelands leases. In 1991, the Secretary of State brought an action against the other trustees in the form of an argument that certain aspects of the Public Tidelands Legislation amounted to an improper "donation" of state public trust lands detrimental to the citizens of the state as beneficiaries. *See* Secretary of State v. Wiesenberg, 633 So. 2d 983, 998 (1994) (finding that Tidelands Act permissibly donated public trust lands); Jarman & McLaughlin, *supra* note 37.

The substantive test requires that any conveyance must meet some higher public purpose. The 1996 land exchange arguably does not trigger this two step process, since the corpus of the trust is augmented rather than depleted. The exchange fulfills the principle purpose of the trust in that the state tidelands and their ecosystems are afforded much greater protection as a result of the Secretary's actions.

The Governor, Secretary of State, and Chancery Court have effectuated the Legislature's ecosystem objective by augmenting the actual corpus of the public trust lands to incorporate substantial tracts of uplands contiguous to important tideland areas. The Legislature's purpose having been carried out, state lawmakers ought to expressly add their ratification to the transaction rather than be deemed to have silently acquiesced to it.

As the above analysis shows, the exchange should survive any procedural challenges to it. The Secretary's land swap embodies the notion set forth by the state supreme court in 1986 focusing on the "the capacity of trust properties to serve those [public trust] needs."[206] But the questions that the exchange raises should encourage future exchanges to involve legislative action or should encourage the Legislature to specifically grant the Secretary of State the authority to make future exchanges in the interest of the public trust.

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[206] Cinque Bambini Partnership v. State, 491 So. 2d 508, 521 (Miss. 1986), *aff'd*, Phillips Petroleum Co. v. Mississippi, 484 U.S. 469 (1988).

OVERVIEW OF ERISA PROVISIONS AND RECENT LEGISLATION GOVERNING GROUP HEALTH PLANS

Deborah Shelby Dees[*]

I. INTRODUCTION

Throughout the United States, employers provide health benefits to their employees by establishing group health plans. Plan designs range from simple, fully-insured arrangements to totally self-funded plans featuring multiple options. Plans may be funded in whole or in part with pre-tax employer contributions and are subject to constant revision because of frequent statutory and regulatory changes. To continue to provide health benefits on a group basis and to ensure the desired tax effects are allowed, employers must comply with the various laws and regulations governing group health plans. Because of recent changes, a large number of group health plan documents are not currently in compliance with the law. This article focuses on the laws governing group health plans, with emphasis on the Employee Retirement Income Security Act of 1974.[1] This article also provides an overview of recent legislation affecting group health plans which must be addressed in implementing and maintaining each group health plan.

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[1] Employee Retirement Income Security Act (ERISA) of 1974, 29 U.S.C. §§ 1001-1461 (1994).

II. ERISA PROVISIONS AFFECTING GROUP HEALTH PLANS

A. *Welfare Benefit Plan Status*

Congress enacted ERISA to regulate employee benefit plans and to protect the funds invested in those plans for plan participants and their beneficiaries.[2] Welfare benefit plans maintained by an employer to provide health benefits to participants and beneficiaries are generally governed by ERISA.[3] The primary protections under ERISA include standards of conduct for fiduciaries, prohibitions against certain transactions, reporting and disclosure requirements, bonding requirements, and coverage continuation requirements.[4] ERISA provides additional protection for plan participants by imposing penalties on employers not in compliance with its provisions.[5] ERISA also subjects group health plans to the regulatory authority of the Department of Labor.[6]

ERISA includes very few requirements regarding the content of welfare plans or the substantive provisions of such plans. ERISA preempts state regulation of welfare plans by superseding all state laws as they relate to employee benefit plans.[7] The ERISA preemption provisions may be used by welfare plan fiduciaries as a shield against tort, contract and regulatory claims. Preemption provisions may also be used in designing welfare benefit plans to prevent the application of state laws requiring the provision of certain mandatory benefits.

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[2] *See* ERISA § 2(a), 29 U.S.C. § 1001(a) (1994).

[3] *See* 29 U.S.C. § 1002(a). ERISA defines "welfare benefit plan" as:

> any plan, fund, or program which was heretofore or is hereafter established or maintained by an employer or by an employee organization, or by both, to the extent that such plan, fund, or program was established or is maintained for the purpose of providing for its participants or their beneficiaries, through the purchase of insurance or otherwise, (A) medical, surgical, or hospital care or benefits, or benefits in the event of sickness, accident, disability, death or unemployment, or vacation benefits, apprenticeship or other training programs, or day care centers, scholarship funds, or prepaid legal services, or (B) any benefit described in section 186(c) of this title.

Id. § 1002(3).

[4] *See id.* §§ 1021-1031, 1101-1114, 1161-1169. The continuation coverage requirements are explained at length in Section III of this article.

[5] *See, e.g.,* ERISA § 2003, 26 U.S.C. § 4975 (1994).

[6] ERISA § 104, 29 U.S.C. § 1024 (1994).

[7] 29 U.S.C. § 1144(a) (1990 & Supp. 1997). The Supreme Court has permitted the state regulation of insurers that sell insurance to employee benefit plans, but state law has not been permitted to be utilized in determining the substan-

B. Reporting and Disclosure Requirements

1. Overview of Reporting and Disclosure Requirements

The enactment of ERISA imposed expansive reporting and disclosure requirements upon administrators of employee benefit plans.[8] In enacting ERISA, Congress concluded that a detailed form of reporting was necessary to protect the rights of plan participants and beneficiaries and to make available to those individuals information which would allow them to determine their position under their benefit plan.[9] In light of this conclusion, there are requirements mandating the reporting of detailed financial data to the Department of Labor and the Internal Revenue Service. There are also requirements mandating that certain documentation and information be provided or made available to participants and beneficiaries covered under the plan upon request. Unless covered by a specific exemption, all welfare benefit plans covered under ERISA are subject to the reporting and disclosure requirements of ERISA.[10] ERISA imposes upon the administrator the respon-

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tive provisions of a welfare benefit plan. Metropolitan Life Ins. Co. v. Massachusetts, 471 U.S. 728, 758 (1985).

[8] ERISA § 514, 29 U.S.C. § 1144. ERISA defines administrator as:

> (i) the person specifically so designated by the terms of the instrument under which the plan is operated;
> (ii) if an administrator is not so designated, the plan sponsor; or
> (iii) in the case of a plan for which an administrator is not designated and a plan sponsor cannot be identified, such other person as the Secretary [of Labor] may by regulation prescribe.

ERISA § 3(16)(A), 29 U.S.C. § 1002(16)(A).

[9] *See* 29 U.S.C. § 1001. Congress rationalized that the dissemination of information concerning plan operations to participants, beneficiaries, and the public would subject dealings of persons controlling the benefit plans to public scrutiny ensuring that plans would be operated in conformity with the laws and in the best interest of the participants and beneficiaries. *See id.* § 1001(a).

[10] *Id.* § 1003(a). Plans maintained by governmental entities and churches are

sibility of filing the required documents with the Department of Labor.[11] ERISA imposes penalties on the administrator for failure to provide information to participants or failure to timely file annual reports.

2. *Overview of Annual Reporting Rules*

ERISA requires the filing of an annual report with the Department of Labor.[12] Plan participants and beneficiaries have the right, upon request, to inspect and receive copies of the full annual report.[13] The administrator is also required to provide participants a written summary of the material features of the report.[14]

The Department of Labor has primary enforcement authority for compliance with the reporting and disclosure provisions of ERISA.[15] The Internal Revenue Service has responsibility for enforcing the filing of annual returns under the Internal Revenue Code.[16] Under coordinated procedures between the Department of Labor and the Internal Revenue Service, a dual purpose annual report form called the Form 5500 is required to be filed by the administrator of a welfare

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exempt. *Id.* § 1003(b). Plans maintained solely for the purpose of complying with applicable workers' compensation laws, unemployment compensation laws, or disability insurance laws are exempt. *Id.* Plans maintained outside of the United States primarily for the benefit of non-resident aliens are exempt. *Id.* The Department of Labor has the authority to exempt welfare benefit plans from all or part of the applicable reporting and disclosure requirements or to provide simplified reporting and disclosure requirements. *Id.* § 1024(a)(3). An unfunded or insured welfare plan maintained by an employer primarily for the purpose of providing benefits for a select group of management or highly compensated employees is exempt from the reporting and disclosure provisions of ERISA. 29 C.F.R. § 2520.104-24 (1997). However, such plans must provide plan documents to the Department of Labor upon request. 29 C.F.R. § 2520.104-24.

[11] 29 U.S.C. § 1021(b).

[12] *Id.* § 1023. The annual report must include information regarding the income and expenses of the plan, the amount and type of assets available to provide benefits, and the occurrence of any prohibited transactions or other events that may jeopardize the plan's ability to pay benefits in the future. *Id.*

[13] *Id.* § 1024(b)(4).

[14] *Id.* § 1024(b)(1).

[15] *Id.* § 1136(b).

[16] I.R.C. § 6039D (1994).

benefit plan with the Internal Revenue Service.[17] The Internal Revenue Service then processes the filing and transmits the information to the Department of Labor.[18]

The deadline for filing Form 5500 for a welfare benefit plan is the last day of the seventh month after the end of the plan year.[19] However, all or part of the penalty otherwise to be assessed can be waived by the Department of Labor upon the showing of reasonable cause for the late filing.[20] The Department of Labor currently has a Delinquent Filer Voluntary Compliance Program under which the filing penalties will be further reduced.[21] The Code imposes an annual return filing requirement on group health plans.[22] Insurance carriers, banks, plan sponsors who are not the plan administrator, and similar organizations holding plan assets have an affirmative duty to transmit and certify, within 120 days from the end of the plan year, the information needed by the plan administrator to prepare the annual report.[23] The plan administrator is also required to make copies of the latest annual report available for examination by any plan participant or beneficiary.[24]

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[17] ERISA § 3004, 29 U.S.C. § 1204 (1990 & Supp. 1997).

[18] 29 U.S.C. § 1204.

[19] *Id.* § 1024(a)(1)(A). This filing deadline may be extended with approval from the Internal Revenue Service for up to two and a half additional months. The extension request is submitted on a Form 5558. Also, a plan administrator is automatically granted a filing extension of the annual report requirement until the due date of the federal income tax return of the employer sponsoring the plan. If the plan year and the employer's tax year are the same, the employer has been granted an extension to file its federal income tax return to a date that extends beyond the normal due date for filing the plan's annual report, and a copy of the federal income tax return filing extension is attached to the annual report when filed.

[20] 29 C.F.R. § 2560.502c-2(d) (1997).

[21] 60 Fed. Reg. 20,874, 20,874 (1995).

[22] I.R.S. Notice 90-24, 1990-1 C.B. 335. However, the Internal Revenue Service has announced that until further notice, such health plans are not required to file an annual report with regard to group health plans under Code § 6039D. *Id.*

[23] ERISA § 103(a)(2), 29 U.S.C. § 1023(a)(2) (1994).

[24] This examination may take place at the administrator's principal office or in other places. 29 U.S.C. § 1024(b)(2). On written request of any participant or beneficiary, the plan administrator must also provide a copy of the latest annual report at a reasonable charge. *Id.* § 1024(b)(4).

Group health plans covering 100 or more participants as of the beginning of a plan year generally must comply with all of the ERISA reporting requirements.[25] These large plans are required to file a complete report at least every third year and a short version in the intervening two years.[26] ERISA includes various exemptions and simplified reporting rules for group health plans covering less than 100 participants at the beginning of any plan year.[27] These small welfare plans are not required to file an independent qualified public accountant's report.[28] In addition, if a welfare benefit plan covering fewer than 100 participants is unfunded or fully insured, then the plan is not required to file an annual report.[29]

3. *Overview of Disclosure Requirement Rules*

ERISA and the regulations thereunder impose upon the plan administrator a duty to furnish (1) certain materials to all participants, (2) certain other materials to participants only upon request, (3) certain documents to be available to participants for inspection at reasonable times and places, and (4) certain plan documents and reports to be filed with the Department of Labor which are then available for public inspection by interested parties.[30]

The plan administrator of a group health plan is required to automatically provide participants with a summary plan description, a summary of material modifications, and a summary annual report.[31] The plan administrator of a plan subject to the Consolidated Omnibus Budget Reconciliation Act (COBRA) of 1985 is also required to provide certain COBRA notices to covered employees.[32] Although the regulations relieve administrators of welfare benefit plans from providing these documents to beneficiaries,[33] a child who is treated as an alternate recipient under a group health plan pursuant to a qualified medical child support order is treated as a participant for purposes of ERISA's reporting and disclosure rules.[34]

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[25] 29 C.F.R. § 2520.104-1 (1997).

[26] *Id.* § 2520.104-41.

[27] *Id.* § 2520-104-20.

[28] *Id.* § 2520.104-46.

[29] *Id.* § 2520.104-20(a). For purposes of qualifying for the fully insured requirement, the exemption applies if benefits under the plan are provided exclusively through insurance contracts or policies issued by an insurance company or similar organization qualified to do business in any state, either through a qualified HMO from its general assets, or partly from its general assets and partly from contributions by the employees or members. This is so provided the contributions by the participants are forwarded by the employer or employee organization within three months of receipt. *Id.* § 2520.104-20(b).

[30] ERISA § 104, 29 U.S.C. § 1024.

[31] 29 U.S.C. § 1021(a) (1994). The administrator of a group health plan is

The delivery of materials is required to be furnished by methods of delivery likely to result in actual receipt by each participant, such as in-hand delivery to an employee at his worksite.[35] The deadline for providing the summary plan description to participants in a plan becoming subject to ERISA is 120 days from the date the plan is adopted or becomes effective.[36] For an ongoing plan, administrators must provide a summary plan description to new participants within ninety days of participation in the plan along with a summary of any material modifications.[37] If material modifications occur within five years of a plan becoming subject to ERISA, then an updated summary plan description must be provided to participants within 210 days of the end of the plan year in which the material modification occurred.[38] The plan administrator must also furnish, upon request, the summary plan description and summary of material modifications to the Department of Labor.[39]

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required to provide each of these documents to plan participants and to beneficiaries who are receiving benefits under the plan. *Id.* § 1021.

[32] I.R.C. § 4980B(f)(6) (1989 & Supp. 1997).

[33] *See* 29 C.F.R. § 2520.104b-1(a) (1997).

[34] ERISA § 609(a)(7)(B), 29 U.S.C.A. § 1169(a)(7)(B) (West Supp. 1997).

[35] 29 C.F.R. § 2520.104b-1(b)(1). Distribution through the mail by first class, or by second or third class with return and forwarding postage guaranteed and address correction requested, is acceptable. *Id.* Placing copies of the material in a location frequented by the participant is not acceptable. *Id.*

[36] ERISA § 104(b)(1)(B), 29 U.S.C. § 1024(b)(1)(B).

[37] 29 U.S.C. § 1024(b)(1)(A).

[38] *Id.* § 1024(b)(1). If no material modification occurs then the administrator must furnish participants with a summary plan description every tenth year. *Id.*

[39] *Id.* § 1024(a)(1)(C). Prior to August 5, 1997, the filing of the summary plan description with the Department of Labor was required on or before the deadline

Upon written request by any participant, the administrator of a group health plan must furnish the participant with a copy of the latest updated summary plan description, the latest Form 5500 and, if applicable, any bargaining agreement, trust agreement, contract or other instrument under which the plan was established or is operated.[40] These documents must be either personally delivered or mailed to the requesting participant.[41] The plan administrator may impose a reasonable charge to cover the cost of furnishing documents which are available only upon request.[42] The plan administrator is not required to provide documents that are unrelated to the administration or operation of the plan.[43] However, data essential to benefit calculations is generally subject to disclosure. A plan administrator may be personally liable for a penalty if the administrator fails or refuses to comply with a request for information.[44] However, that penalty will not be imposed in the event the delay is the result of matters beyond the control of the administrator.[45]

The plan administrator must make the documents which are available upon request available for review at the administrator's principal office.[46] The documents provided to the Department of Labor which are subject to public inspection include the Form 5500, the summary plan description, the summary of material modifications, the plan description, any terminal reports, and any additional documents requested by the

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for providing copies of the documents to the participants. 29 C.F.R. § 2520.104b-2.

[40] ERISA § 104(b)(4), 29 U.S.C. § 1024(b)(4).

[41] 29 C.F.R. § 2520.104b-1(b)(2).

[42] ERISA § 104(b)(4), 29 U.S.C. § 1024(b)(4). That charge may not exceed twenty-five cents. 29 C.F.R. § 2520.104b-30(b). Charges for handling or postage are not deemed reasonable, and the plan administrator must provide information to a participant upon request regarding the charge that would be imposed to provide a copy of any document. 29 C.F.R. § 2520.104b-30(b).

[43] DOL Advisory Opinion 87-10A (1987). The Department of Labor has ruled that minutes of meetings of fiduciaries are not generally subject to disclosure.

[44] ERISA § 502(c)(1), 29 U.S.C. § 1132(c)(1) (1994). The penalty is $100 per day from the date of the failure, which will begin thirty days after the request. 29 U.S.C. § 1132(c)(1).

[45] *Id.*

[46] *Id.* § 1024(b)(2).

Department of Labor.[47]

The plan administrator must include information in the summary plan description which describes the role of insurance issuers under a group health plan and directions for seeking assistance from the Department of Labor.[48] Participants in a group health plan must be notified, within specified time frames, of material reductions in benefits and services.[49]

C. Fiduciary Responsibility Requirements

ERISA requires that welfare benefit plans be established and maintained pursuant to a written instrument and that the written instrument name at least one fiduciary.[50] Welfare plan fiduciaries include not only the person named as a fiduciary, but also anyone who exercises discretionary control or authority over the plan, its management, or its assets.[51]

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[47] *Id.* § 1024(a)(1).

[48] ERISA § 102(b) (West Supp. 1997). The summary plan description must include the office at the Department of Labor through which participants and beneficiaries may seek assistance or information with regard to their rights under HIPAA and ERISA. ERISA § 102(b); 29 C.F.R. § 2520.102-3(t)(2). The summary plan description must clearly inform participants and beneficiaries whether the issuer is serving as a contract administrator or claims payor rather than an insurer. *Id.* Where the insurable issuer is responsible for any of the financing or administration of the plan, the summary plan description must include (1) the name and address of the issuer, (2) whether and to what extent benefits under the plan are guaranteed under a contract or insurance policy with the issuer, and (3) the nature of any administrative services provided by the issuer. *Id.*

[49] ERISA § 104(b)(1), 29 U.S.C.A § 1024(b)(1) (West Supp. 1997); 29 C.F.R. § 2520.104b-3. The summary of such modifications or changes must be furnished to participants and beneficiaries not later than sixty days after the adoption of the modification, unless the plan sponsor provides summaries of modifications at regular intervals of not more than ninety days. 29 U.S.C.A. § 1024(b)(1).

[50] ERISA § 402(a)(1), 29 U.S.C. § 1102(a)(1). The instrument must provide for one or more named fiduciaries who have authority to control and manage the operation and administration of the plan. 29 U.S.C. § 1102(a)(1). The instrument must provide a procedure for establishing and carrying out a funding policy and must describe any procedure for the allocation of responsibilities for the operation and administration of the plan. *Id.* § 1102(b). Procedures must be provided for amending the plan and identifying the persons who have authority to amend the plan. *Id.* The instrument must specify the basis for making incoming and outgoing payments. *Id.*

[51] *Id.* § 1002(21)(A). ERISA provides that a person is a "fiduciary" of a plan

Some offices or positions of an employee benefit plan require, by their very nature, persons who hold them to perform one or more fiduciary functions.[52] Any person may serve in more than one fiduciary capacity with respect to a plan, and a named fiduciary or a fiduciary designated by a named fiduciary may employ one or more persons to render advice with regard to any responsibility the fiduciary has under a plan.[53] ERISA subjects fiduciaries who breach their duties to a variety of penalties, including the personal obligation to reimburse a plan for any losses resulting from a breach of fiduciary duty.[54]

ERISA prohibits certain transactions between welfare benefit plans and parties in interest.[55] ERISA defines "party in interest" in great detail to give fiduciaries clear guidance when evaluating transactions.[56] ERISA specifically prohibits

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to the extent:

> (i) he exercises any discretionary authority or discretionary control respecting management of such plan or exercises any authority or control respecting management or disposition of its assets; (ii) he renders investment advice for a fee or other compensation, direct or indirect, with respect to any monies or other property of such plan, or has any authority or responsibility to do so; or (iii) he has any discretionary authority or discretionary responsibility in the administration of such plan.

Id.

[52] 29 C.F.R. § 2509.75-8 Q&A D-3 (1997). Furthermore, the regulation provides that a plan administrator or a trustee of a plan must by the very nature of his position have "discretionary authority or discretionary responsibility in the administration" of the plan; therefore, persons who hold such positions are fiduciaries. 29 C.F.R. § 2509.75-8 Q&A D-3.

[53] ERISA § 405(c)(1)(B), 29 U.S.C. § 1105(c)(1)(B). For example, the named fiduciary may appoint an investment manager.

[54] 29 U.S.C. § 1109(a). ERISA allows the Secretary of Labor or any plan beneficiary, participant, or fiduciary to bring a civil action for appropriate relief under section 409 of ERISA. *Id.* § 1132(a)(2).

[55] *Id.* § 1106. ERISA provides that a plan fiduciary shall not cause a plan to engage in certain prohibited transactions between the plan and a party in interest. *Id.* § 1106(a).

[56] *See id.* § 1002(14). ERISA defines a party in interest as:

> (A) any fiduciary (including, but not limited to, any administrator, officer, trustee, or custodian), counsel, or employee of such employee benefit plan;
> (B) a person providing services to such plan;

a fiduciary from engaging in a transaction involving a party in interest if he knows or should know that the transaction is a direct or indirect:

> (A) sale or exchange, or leasing, of any property between the plan and a party in interest;
> (B) lending of money or other extension of credit between the plan and a party in interest;
> (C) furnishing of goods, services, or facilities between the plan and a party in interest;
> (D) transfer to, or use by or for the benefit of a party in interest, of any assets of the plan; or
> (E) acquisition, on behalf of the plan, of any employer security or employer real property in violation of § 1107(a) of this ti-

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> (C) an employer any of whose employees are covered by such plan;
> (D) an employee organization any of whose members are covered by such plan;
> (E) an owner, direct or indirect, of 50 percent or more of-
>> (i) the combined voting power of all classes of stock entitled to vote or the total value of shares of all classes of stock of a corporation,
>> (ii) the capital interest or profits interest of a partnership, or
>> (iii) the beneficial interest of a trust or unincorporated enterprise, which is an employer or an employee organization described in subparagraph (C) or (D);
>
> (F) a relative (as defined in paragraph (15)) of any individual described in subparagraphs (A), (B), (C) or (E);
> (G) a corporation, partnership, or trust or estate of which (or in which) 50 percent or more of-
>> (i) the combined voting power of all classes of stock entitled to vote or the total value of shares of all classes of stock of such corporation,
>> (ii) the capital interest or profits interest of such partnership, or
>> (iii) the beneficial interest of such trust or estate is owned directly or indirectly, or held by persons described in subparagraphs (A), (B), (C), (D) or (E);
>
> (H) an employee, officer, director (or an individual having powers or responsibilities similar to those of officers or directors), or a 10 percent or more shareholder directly or indirectly, of a person described in subparagraphs (B), (C), (D), (E), or (G), or of the employee benefit plan; or
> (I) a 10 percent or more (directly or indirectly in capital or profits) partner or joint venturer of a person described in subparagraphs (B), (C), (D), (E) or (G).

Id.

> tle.[57]

In addition to prohibiting transactions between plans and parties in interest, ERISA prohibits certain transactions between the plan and fiduciaries of the plan.[58] ERISA prohibits a fiduciary from:

> (A) [dealing] with the assets of the plan in his own interest or for his own account;
> (B) in his individual or in any other capacity act[ing] in any transaction involving the plan on behalf of a party (or represent[ing] a party) whose interests are adverse to the interests of the plan or the interests of its participants or beneficiaries; or
> (C) receiv[ing] any consideration for his own personal account from any party dealing with such plan in connection with a transaction involving the assets of the plan.[59]

The standard of conduct imposed on fiduciaries is that of the prudent man.[60] A fiduciary is required to discharge his duties in the sole interest of the participants and the beneficiaries.[61] Specifically, a fiduciary must act:

> (A) [with] the exclusive purpose of (i) providing benefits to participants and their beneficiaries; and (ii) defraying reasonable expenses of administering the plan;

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[57] ERISA § 406(a)(1), 29 U.S.C. § 1106(a)(1). ERISA also prohibits a fiduciary who has authority or discretion to control or manage the assets of a plan from permitting the plan *to hold* any employer security or employer real property if he knows or should know that holding such security or real property violates 29 U.S.C. § 1106(a)(2). Welfare benefit plans fall under a specific prohibition from acquiring any qualifying employer securities or real property if immediately after such acquisition the aggregate fair market value of the employer securities and real property held by the plan exceeds 10% of the fair market value of the plan assets. *Id.* § 1107(a). Only an administrative exemption from the prohibited transaction rules would permit the investment of welfare plan assets in qualifying employer securities or qualifying employer real property in excess of 10% of the value of the fund. *Id.*

[58] *Id.* § 1106(b). ERISA § 406(b) contains separate provisions prohibiting certain transactions between a plan and fiduciary of such plan. *Id.*

[59] *Id.*

[60] *Id.* § 1104(a).

[61] *Id.*

> (B) with the care, skill, prudence, and diligence under the circumstances then prevailing that a prudent man acting in a like capacity and familiar with such matters would use in the conduct of an enterprise of a like character and with like aims;
> (C) divers[ify] the investments of the plan so as to minimize the risk of large losses, unless under the circumstances it is clearly prudent not to do so; and
> (D) in accordance with the documents and instruments governing the plan insofar as such documents and instruments are consistent with the provisions of [ERISA].[62]

The standard of review of fiduciary actions is set forth in *Firestone Tire & Rubber Co. v. Bruch.*[63] In *Firestone*, the Supreme Court set forth a two-step analysis.[64] Plan fiduciary decisions are to be reviewed *de novo*, without any deference to the fiduciary's decisions.[65] However, the *de novo* standard becomes inapplicable if the plan grants a fiduciary discretionary authority to construe and interpret the plan and to administer its terms and provisions. In that case, a fiduciary's decision may be reversed only if it constitutes an abuse of the conferred discretion.[66] When the abuse of discretion standard applies, a plan administrator's decision must be sustained as a matter of law unless proven arbitrary or capricious.[67]

An individual's status as a fiduciary is significant because of the potential liability of a fiduciary versus a non-fiduciary. Various cases have limited the liability of non-fiduciaries involved in a fiduciary breach.[68] In *Mertens v. Hewitt Assocs.*, the Supreme Court held that ERISA does not permit the assessment of monetary damages against a non-fiduciary who knowingly participates in a breach of fiduciary responsibility.[69] In *Reich v. Rowe*, the First Circuit held that equitable relief was not available under ERISA against a non-fiduciary unless the non-fiduciary participated in a prohibited transaction as a party in interest.[70] These two cases support the conclusion that only non-fiduciaries who participate in prohibited transactions may be held personally liable under ERISA for breach of fiduciary duty. Individuals performing services for welfare benefit plans should take particular note of this conclusion since the individual may function in a capacity that may or may not be fiduciary in nature. Where the employee exercises discretionary authority, the function may rise to that of a fiduciary function. An individual who is a plan administrator and appointed by a fiduciary to perform particular functions regarding the plan is presumed a fiduciary unless shown otherwise.

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[62] 29 U.S.C. § 1104(a).

[63] 489 U.S. 101, 115 (1989).

[64] *Firestone*, 489 U.S. at 115.

[65] *Id.* Under *de novo* review, the Court is to objectively determine the correct decision on the facts and under the plan documents.

[66] *Id.*

[67] Adamo v. Anchor Hoching Corp., 720 F. Supp. 491, 500 (W.D. Pa. 1989). Arbitrary and capricious has been defined as a decision that is without reason, unsupported by substantial evidence, or erroneous as a matter of law. *Adamo*, 720 F. Supp. at 500.

[68] *See* Concha v. London, 62 F.3d 1493, 1504 (9th Cir. 1995) (stating that equitable relief is sole remedy against non-fiduciaries under ERISA); Gruby v.

In *Massachusetts Mutual Life Insurance Co. v. Russell*, the Supreme Court held that a fiduciary's potential liability extends only to making the plan whole, not to compensating the individual participants.[71] The Court, therefore, denied the participant's claim for extra-contractual and punitive damages resulting from the improper and untimely processing of a claim for benefits.[72] For a welfare plan participant to prevail on an ERISA-based claim against a service provider, or for a named fiduciary to bring an action utilizing ERISA-derived claims, the service provider must be shown to be a fiduciary, the service provider must have committed a fiduciary breach, and the relief sought must be equivalent to the equitable remedy of

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Brady, 838 F. Supp. 820, 835 (S.D.N.Y. 1993) (denying plaintiff's claim for monetary damages against non-fiduciaries). *But cf.* Reich v. Continental Cas. Co., 33 F.3d 754, 757-58 (7th Cir. 1994) (stating with reservations that ERISA prohibits monetary damages against non-fiduciaries).

[69] Mertens v. Hewitt Assocs., 508 U.S. 248, 261-62 (1993).

[70] Reich v. Rowe, 20 F.3d 25, 34-35 (1st Cir. 1994).

[71] Massachusetts Mut. Life Ins. Co. v. Russell, 473 U.S. 134, 140 (1985).

[72] *Russell*, 473 U.S. at 148.

restitution.[73]

ERISA generally requires fiduciaries and persons handling plan assets to be bonded to provide a source of plan compensation for losses resulting from fraud or dishonesty.[74] The amount of the bond, which is fixed at the beginning of each fiscal year of the plan, must not be less than ten percent of the plan asset amount handled, with a minimum of $1,000 and a maximum of $500,000.[75]

D. Plan and Trust Requirements

ERISA requires every employee benefit plan to be established pursuant to a written document.[76] The written plan must provide for one or more named fiduciaries who jointly and severally have authority to control and manage the plan's operation and administration.[77] ERISA further requires that every plan provide: (1) a procedure for carrying out a funding policy in a method consistent with the objectives of the plan and of the statute; (2) a description of any procedure for allocating responsibility for operating and administering the plan (including any procedure for allocating fiduciary duties among the plan's various fiduciaries); (3) procedures for amending the plan and identifying persons who have authority to amend the plan; and (4) the basis on which contributions are made and benefits are paid.[78] ERISA also requires the assets of an employee benefit plan to be held in trust by one or more trustees with the trustees named in the plan document or appointed by a named fiduciary.[79]

Typically the plan sponsor's board of directors appoints the trustee and the trustee has the exclusive authority and discretion to manage and control the assets of the plan. The board of directors retains the fiduciary responsibility of monitoring the trustee's actions to determine if the trustee continues to fulfill its duties. The fiduciary responsibility for the handling of plan assets commences when the property or claim becomes a plan asset. The assets of employee welfare benefit plans frequently consist of the employer's unfunded promise to pay, or one or more insurance contracts, which are exempt from the trust requirements.

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[73] *Id.* at 140.

[74] ERISA § 402, 29 U.S.C. § 1112 (1994).

[75] 29 U.S.C. § 1112.

[76] *Id.* § 1102(a)(1).

[77] *Id.*

[78] *Id.* § 1102(b).

[79] *Id.* § 1103(a).

1. Plan Assets

ERISA requires that all assets of an employee benefit plan be held in trust.[80] However, the trust requirement does not apply to assets consisting of insurance contracts or policies issued by an insurance company qualified to do business in a state, to any assets of such an insurance company or any assets of a plan held by such an insurance company, or to a plan which the Secretary exempts from the trust requirements.[81]

There has been considerable controversy over when and if employee contributions become plan assets and must be transferred to a trust. In the case of payroll deductions, the contribution is deemed made at the time the amount would have otherwise been paid to the employee.[82] Employee-derived contributions become plan assets as of the earliest date on which the contributions can reasonably be segregated from the employer's general assets.[83] The regulations appear to provide a ninety-day safe harbor period from the date on which such amounts are received by the employer.[84] Plan fiduciaries who fail to collect plan assets within the requisite time frame breach their fiduciary responsibilities and have engaged in a prohibited transaction.[85] The Department of Labor has clarified that the final regulations apply to employee contributions which are transmitted to an insurer, thereby subjecting the contributions to a trust requirement if they are held outside the ninety-day safe harbor.[86] Such contributions, consequently, cannot be expended for non-benefit purposes.

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[80] ERISA § 403(a), 29 U.S.C. § 1103(a) (1994).

[81] 29 U.S.C.A. § 1103(b) (West Supp. 1997).

[82] 29 C.F.R. § 2510.3-102 (1997).

[83] *Id.*

[84] *See id.*

[85] ERISA §§ 406, 409, 29 U.S.C. §§ 1106, 1109 (1994).

2. *Cafeteria Plans*

The Department of Labor has stated that it will not assert a violation in an enforcement proceeding solely for failure to hold participant contributions to cafeteria plans in trust.[87] Also, cafeteria plans that do not maintain participant contributions in trust are not required to comply with reporting requirements that would otherwise apply if the contributions were held in trust.[88]

3. *Segregation of Assets*

Segregation of employer assets to fund welfare benefit plans may be treated as creating plan assets. If the employer assets are held to be plan assets, such assets become subject to the trust requirement as well as all of the provisions that are applicable under ERISA. The Department of Labor treats a checking account, or a payment arrangement under which a third party administrator of a welfare plan writes checks directly on the employer's account to pay claims, as remaining the employer's property and not a plan asset, as long as the account is labeled as the property of the employer and the plan documents do not require the accounts to be maintained in the name of the plan.[89] If the account is maintained by the plan, such account constitutes plan assets and must be held in trust.

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[86] ERISA Tech. Release 92-01, 6 Pens. & Profit Sharing 2d (RIA) ¶ 97,430, at 97,405 (June 2, 1992). ERISA Opinion Letter 92-24A (1992) also provides that employee contributions are subject to ERISA trust requirements unless they are used to purchase insurance that is a plan asset or to pay plan benefits. ERISA Opinion Letter 92-24A, 6 Pens. & Profit Sharing 2d (RIA) ¶ 90,462, at 90,671 (November 6, 1992).

[87] ERISA Tech. Release 92-01, 6 Pens. & Profit Sharing 2d (RIA) ¶ 97,430, at 97,406 (June 2, 1992). However, the Department of Labor statement does not bar private actions for violations of the trust requirements. *Id.* at 97,407.

[88] *Id.*

[89] ERISA Opinion Letter 92-24A, 6 Pens. & Profit Sharing 2d (RIA) ¶ 90,462, at 90,670 (Nov. 6, 1992).

The Department of Labor provides that a plan sponsor may maintain a plan without plan assets by paying plan benefits exclusively from the employer's general assets.[90] However, as soon as the plan gains a beneficial interest in the assets, the assets become plan assets. Where an employer establishes a trust on behalf of a plan, sets up a separate account in the name of a plan with a bank or third party, or specifically indicates in the plan document that separately maintained funds belong to the plan, such assets will become plan assets. However, the Department of Labor has generally concluded that the mere segregation of employer funds to facilitate administration of the plan does not, in itself, demonstrate an intent to create a beneficiary interest in those assets for the plan. The question of whether a plan acquires a beneficial interest in definable plan assets depends substantially upon whether the plan sponsor has expressed an intent to grant such an interest or has made representations to plan participants and beneficiaries that the subject funds separately secure the promised benefits or are otherwise plan assets.

In no event will employee contributions become plan assets later than ninety days after the employer receives such amounts or such amounts would be payable to the participant.[91] The Department of Labor regulations provide two examples which show that payment of participant contributions on a monthly basis satisfies the regulation in the case of a larger national corporation with multiple pay periods but not in the case of a small company which pays employees from a single payroll center.[92]

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[90] ERISA Opinion Letter 94-31A, 6 Pens. & Profit Sharing 2d (RIA) ¶ 90,529, at 90,759 (Sept. 9, 1994).

[91] 29 C.F.R. § 2510.3-102(c).

[92] *See* 29 C.F.R. § 2510.3-102(c).

E. VEBA Requirements

The Internal Revenue Code (Code) exempts voluntary employees' beneficiary associations (VEBA) from income tax.[93] A VEBA is a tax-exempt funding mechanism for group health plans, and it must obtain a tax exemption from the Internal Revenue Service (IRS).[94] A VEBA must file form 1024 with the IRS within twenty-seven months from the end of the month in which the VEBA is organized.[95] A VEBA is also required to file other forms such as Forms 5500, 990, and 990T.[96]

F. Internal Revenue Code Provisions Affecting Group Health Plans

1. Overview of Code Provisions

For group health plans in compliance with applicable Code provisions, the employer sponsoring such a plan may generally deduct the cost of providing benefits under the plan for income tax purposes,[97] and such costs are exempt from employment taxes.[98] Employees under group health plans generally may exclude the cost of health and medical benefits from their taxable income.[99] Applicability of Code provisions for purposes of the taxability of a group health plan depends on whether the health benefits are paid entirely by the employer or paid partially or fully by employee contribution. Separate Code provisions govern the tax treatment of the actual payment of medical expenses by the health plan and the value of the health coverage under the plan.[100]

Amounts received by an employee through a group health plan for personal injuries or sickness are included in the employee's gross income to the extent such amounts are either attributable to contributions by the employer which were not includable in the employee's gross income or paid by the employer.[101] However, the Code provides that amounts received by an employee through a group health plan are not included in the employee's gross income if the amounts are paid, directly or indirectly, to the employee as reimbursement for qualified medical care expenses incurred by the employee or the employee's spouse or dependents.[102] The gross income of an employee will not include employer-provided coverage under an accident or health plan.[103] The Code includes nondiscrimination standards for group health plans that are self-insured.[104]

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[93] I.R.C. §§ 501(a), 501(c)(9) (1994).

[94] 29 C.F.R. § 1.501(C)(9)-1-8 (1981); 26 C.F.R. § 1.505(c)-IT Q&A-3 (1986).

[95] 26 C.F.R. § 1.505(c)-IT Q&A-6 (1986); 26 C.F.R. § 601.105.

[96] 26 U.S.C. § 1024(a)(1)(A) (1990 & Supp. 1997); 26 C.F.R. § 1.6033-1(2)(i); I.R.C. § 6012(a) (1989 & Supp. 1997); 26 C.F.R. § 1.6012-3(a)(5).

[97] 26 C.F.R. § 1.505(c)-IT Q&A-6.

[98] U.S.C. § 6012(a); 26 C.F.R. § 1.6033-2(a)(2)(ii); 26 C.F.R. § 1.6012-3(a)(5).

[99] I.R.C. § 105 (1994).

[100] *Id.* §§ 105, 106.

2. *Deductibility of Contributions*

With the exception of self-employed individuals such as sole proprietors, partners, and two percent shareholders of S corporations, amounts paid by an employer to provide accident and health benefits to its employees and their dependents are deductible for income tax purposes as an ordinary and necessary business expense to the extent that the costs are not paid or reimbursable by insurance or some other source.[105] If the benefits are provided under a non-insured welfare benefit plan or benefit fund, the Code controls the deductibility of the contributions to the funds.[106]

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[101] *Id.* § 105(a).

[102] *Id.* § 105(c).

[103] *Id.* § 106(a).

[104] I.R.C. § 105(h). To the extent the nondiscrimination standards are violated, benefits provided under the group health plan to highly compensated individuals are includable in gross income. *Id.*

[105] *Id.* § 162(a).

[106] *Id.* § 419 (West Supp. 1997). The Code prevents an employer from claiming premature deductions for expenses that have not yet been incurred by a welfare benefit fund sponsored by the employer that holds assets used to provide benefits to employees. *Id.* If contributions otherwise satisfy the requirements for deductibility under the Code, such contributions will be deductible for the taxable year in which the contributions are paid to the extent that the amount of the contributions do not exceed the welfare benefit fund's qualified costs for the taxable year of the fund relating to the taxable year of the employer. *Id.*

3. Limits on Deductibility

An employer contribution in excess of contributions permitted under the Code will not be deductible by the employer and may be subject to an unrelated business income tax as well as a 100% excise tax.[107] There is an exception from the limitations under the Code for a welfare benefit fund that is part of a qualified "ten or more employer plan," provided that the plan does not maintain experience-rating arrangements regarding individual employers.[108] For medical benefits, the account limit for any taxable year is the amount reasonably and actuarially necessary to fund claims for medical expenses incurred but unpaid as of the end of the taxable year and the administrative costs attributable to such claims.[109] There is a statutory safe harbor limit for medical benefits equal to 35% of the qualified direct costs other than insurance premiums for the immediately preceding taxable year.[110]

4. Discrimination Provisions

A self-insured plan will be considered discriminatory if it discriminates in favor of highly compensated individuals, either as to participation eligibility or benefits.[111] For this purpose, a "highly compensated individual" includes an individual who is one of the five highest paid officers of the employer or a shareholder who owns more than ten percent of the stock of the employer or is among the highest paid twenty-five percent of all employees.[112] Employees who have not completed three years of service, who have not attained age twenty-five, who are part-time or seasonal employees, who are included in a unit covered by a collective bargaining agreement, or who are non-resident aliens receiving no earned income sources within the United States are excluded from the definition of highly compensated individuals as it applies to ERISA discrimination.[113]

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[107] *Id.* §§ 419, 419A, 4976. The Code provides that the amount of the allowable deduction for contributions to a welfare benefit fund is equal to the sum of the fund's qualified direct costs for the year and the additions to the fund's qualified direct costs for the year and the additions to the account under the fund for the year, reduced by the after-tax income of the fund. *Id.* § 419. A carryover is provided for contributions in excess of the deduction limit. *Id.* § 419(d).

[108] *Id.* §§ 419, 419A.

[109] I.R.C. § 419A(c)(1).

[110] *Id.* § 419A(c)(5)(B)(ii).

[111] *Id.* § 105(h)(2) (West Supp. 1997). With regard to eligibility, the self-insured plan must benefit 70% or more of all employees or 80% or more of all employees eligible for benefits under the plan, if 70% or more of all employees are eligible for benefits under the plan, or such employees qualify under classifications set up by the employer which the Secretary of the Treasurer has determined to be nondiscriminatory in favor of highly compensated employees. *Id.* § 105(h)(2).

III. COBRA REQUIREMENTS

A. *Historical Overview*

The Consolidated Omnibus Budget Reconciliation Act of 1985 (COBRA) amended the Code and ERISA to include continuation coverage requirements for employer provided group health plans.[114] The COBRA rules have been revised by the Tax Reform Act of 1986 (TRA), the Technical and Miscellaneous Revenue Act (TAMARA) of 1988, the Omnibus Budget Reconciliation Act (OBRA '89) of 1989, the Omnibus Budget Reconciliation Act (OBRA '90) of 1990, the Omnibus Budget Reconciliation Act (OBRA '93) of 1993, the Small Business Job Protection Act of 1996 ('96 Act) and HIPAA. In addition, the Treasury Department has issued proposed regulations interpreting COBRA.[115] The Department of Labor has also issued guidance on compliance with COBRA provisions and a model notice to be sent to employees, spouses and retirees covered under group health plans.

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[112] *Id.* § 105(h)(5).

[113] *Id.*

[114] The COBRA provisions in the Code were originally enacted as Code § 162(k). However, TAMARA deleted Code § 162(k) and added Code § 4980B, which is the current Code section covering COBRA continuation requirements. I.R.C. § 4980B (West Supp. 1997).

[115] The 1987 proposed regulations are currently outstanding and have not been revised to reflect some of the legislation subsequent to their issuance. *See* Prop. Treas. Reg. § 1.152-26, 52 Fed. Reg. 22,716 (1987). The 1998 proposed regulations provide guidance on certain changes made by HIPAA, OBRA, '89 and TAMARA. *See* Prop. Treas. Reg. § 54.4980B-1, 63 Fed. Reg. 708 (1998).

B. Overview of COBRA

Under COBRA, group health plans must continue to make coverage available to employees and their dependents who would otherwise lose benefits as a result of a certain "qualifying event."[116] The continuation rules enacted by Congress provide employees and their dependents with transitional medical benefit coverage in the event of a change in employment or job status.[117] COBRA continuation applies to the "core benefits" provided under any group health plan furnishing medical care benefits for employees and their dependents regardless of whether the plan is insured or self-funded.[118]

The continuation requirement is triggered by the occurrence of a "qualifying event."[119] The period over which self-financed coverage must be extended depends on the qualifying event, as well as the qualified beneficiary.[120] Under COBRA, employers and plan administrators have significant obligations to inform employees and qualified beneficiaries of their continuation rights and to provide such persons with a specified time frame to elect continuation coverage.[121] As a result of the statutory election period,[122] a plan may be responsible for paying benefits retroactively. Also, failure to comply with COBRA may result in tax penalties and liability for payment of benefits not otherwise required.[123] To ensure COBRA compliance, employers should implement and update training procedures, provide written instructions for those performing the compliance functions, and have compliance audits performed or monitored by independent auditors.

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[116] I.R.C. § 4980B(f) (West Supp. 1997).

[117] *Id.* § 4980B.

[118] *See id.* Governmental plans and church plans are not subject to the COBRA requirements. *Id.* § 4980B(d)(2)-(3). Governmental plans and church plans are defined in I.R.C. § 414(d)-(3). However, similar requirements are applicable to state and local governments. Public Health Service Act § 300bb-1. In addition, "small employer" plans are not subject to COBRA. I.R.C. § 4980B(g)(2). The Code, as amended by HIPAA, specifically excludes from the definition of "group health plan" any plan substantially all of the coverage under which is for qualified long-term care services. *Id.* § 4980B(g)(2).

[119] *See id.* § 4980B(f)(1).

[120] *See id.* § 4980B(f)(2)(B).

[121] I.R.C. § 4980B(f)(6).

[122] *Id.* § 4980(f)(5).

[123] *Id.* § 4980(a).

C. Plans Which Must Comply with COBRA

COBRA does not apply to any qualified beneficiary under a group health plan whose qualifying event occurred during the calendar year immediately following a calendar year during which all employers maintaining the plan normally employed fewer than twenty employees on a typical business day. An employer is considered as having normally employed fewer than twenty employees during a particular calendar year only if it had fewer than twenty employees on at least fifty percent of its working days during that year.[124]

A cafeteria plan or other flexible benefit arrangement which provides medical care is subject to COBRA continuation requirements to the extent of the medical benefits under the cafeteria plan or other arrangement that a covered employee has actually chosen to receive.[125] For example, a covered employee who terminates employment where such termination constitutes a qualifying event must be offered an opportunity to elect COBRA continuation coverage if the covered employee has previously elected a flexible spending arrangement providing health care. In addition, if an open enrollment period for active employees occurs while the covered employee is still receiving the continuation coverage, then the covered employee must be offered the opportunity to switch to any other health plan being offered during the open enrollment period.

Entities including the Federal Deposit Insurance Corporation, the Resolution Trust Corporation, and bridge banks which take over failed financial institutions, but not specifically the institution acquiring the assets, are required to offer COBRA continuation coverage to the employees of the failed institution.[126]

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[124] Prop. Treas. Reg. § 1.162-26 Q&A-9(b), 52 Fed. Reg. at 22,716. In determining the number of employees, an employer is to treat as employees all full-time and part-time employees and all self-employed employees within the meaning of Code § 401(c)(1). *Id.* An employer is also to treat as employees all agents, independent contractors, and directors only if such individuals are eligible to participate in a group health plan maintained by the employer. *Id.*

[125] Prop. Treas. Reg. § 1.162-26 Q&A-10, 52 Fed. Reg. at 22,716.

D. Qualified Beneficiaries

The Code defines "qualified beneficiary" to include any individual who was, on the day before a qualifying event, a beneficiary under the group health plan as the covered employee,[127] the spouse of the covered employee,[128] or the dependent child of the covered employee.[129] The group of qualified beneficiaries is closed as of the day before the qualifying event.[130] Spouses who subsequently join the family are not qualified beneficiaries.[131] Even when new family members are covered under the plan, such family members do not become qualified beneficiaries.[132] However, effective January 1, 1997, HIPAA revised the Code to include any child born to, adopted by or placed for adoption with a covered employee during the period of continuation coverage as a qualified beneficiary.[133]

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[126] Pub. L. No. 102-242, § 451.

[127] The Code defines "covered employee" as an individual who is or was provided coverage under a group health plan by virtue of the performance of services by the individual for one or more persons maintaining the plan. I.R.C. § 4980B(f)(7) (1994). This definition includes an employee who is self-employed as defined in Code § 401(c)(1). *Id.* A retiree or former employee who is covered by a group health plan is a covered employee if the coverage results in whole or in part from his or her previous employment. Prop. Treas. Reg. 1.162-26 Q&A-16(a), 52 Fed. Reg. at 22,716. An individual who is merely eligible for coverage is not a covered employee if the individual is not and has not been actually covered under the plan. *Id.* Covered employees include individuals who are actually covered under a group health plan which also covers common law employees of the employer maintaining the plan, where the individual is with regard to such employer a self-employed person pursuant to Code § 401(c)(1), an agent, or independent contractor (or an employee of an agent or independent contractor), or a director in the event the employer is a corporation. Prop. Treas. Reg. § 1.162-26 Q&A-16(b), 52 Fed. Reg. at 22,716.

[128] I.R.C. § 4980B(g)(1)(A) (1994). A covered employee's dependent who ceases to qualify as a dependent may elect continuation coverage. *Id.* § 4980B(f)(3)(E). If this former dependent then marries and enrolls his spouse in the plan, the spouse is not a qualified beneficiary. Prop. Treas. Reg. § 1.162-26 Q&A-17(C)(3), 52 Fed. Reg. at 22,716. Where a single employee voluntary terminates employment and properly elects COBRA continuation coverage under a group health plan, marriage by such employee subsequent to such election may result under the plan in coverage of the new spouse; however, the new spouse is not a qualified beneficiary. Prop. Treas. Reg. § 1.162-26 Q&A-17(c)(2), 52 Fed. Reg. at 22,716. Therefore, if the new spouse dies during the period of COBRA continuation coverage, the plan does not have to offer the new surviving spouse an opportunity to elect COBRA continuation coverage. *Id.*

[129] I.R.C. § 4980B(g)(1).

[130] *Id.*

An individual may not become a qualified beneficiary as a result of a qualifying event if the individual is covered under the group health plan because of another individual's election of continuation coverage.[134] Where an individual, upon retirement, declines the opportunity to elect continuation coverage in favor of an alternative offer of twelve months of employer-paid retiree health benefits, the individual ceases to be a qualified beneficiary and will not have to be given another opportunity to elect COBRA continuation coverage at the end of those twelve months.[135] If the individual marries during the period of retiree health coverage, and under the terms of the coverage, the new spouse is covered under the plan, a divorce or death of the retiree will result in loss of coverage for the spouse. Therefore, the spouse will be a qualified beneficiary because the spouse's coverage under the plan on the day before the qualifying event will have been by reason of the retiree's acceptance of twelve months of employer-paid coverage after the prior qualifying event rather than by reason of an election of COBRA continuation coverage.[136] In the event the divorce or death of the retiree does not cause the spouse to lose coverage so that the spouse continues to be covered for the balance of the original twelve month period, the spouse does not have to be allowed to elect COBRA continuation coverage because the divorce or death does not constitute a qualifying event.[137]

Where a married, covered employee terminates employment and elects continuation coverage for himself but not for his spouse and his spouse declines coverage, the spouse may be added to the plan during the next open enrollment period; however, the spouse will not be a qualified beneficiary.[138]

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[131] Prop. Treas. Reg. § 1.162-26 Q&A-17(a), 52 Fed. Reg. at 22,716.

[132] I.R.C. § 4908(g)(1)(A) (1989 & Supp. 1997).

[133] *Id.* § 4908-B(g)(1)(A).

[134] Prop. Treas. Reg. § 1.162-26 Q&A-15(b), 52 Fed. Reg. at 22,716.

[135] Prop. Treas. Reg. § 1.162.26 Q&A-17(c)(4), 52 Fed. Reg. at 22,716.

[136] *Id.*

[137] Prop. Treas. Reg. § 1.162-26 Q&A-17(c)(5), 52 Fed. Reg. at 22,716.

E. Qualifying Event

The Code defines "qualifying event" to include any of the following events which, but for the continuation coverage required under COBRA, would result in the loss of coverage for a qualified beneficiary:

> (A) The death of the covered employee;
> (B) The termination (other than by reason of the employee's gross misconduct), or reduction of hours of the covered employee's employment;
> (C) The divorce or legal separation of the covered employee from the employee's spouse;
> (D) The covered employee becoming entitled to Medicare benefits under Title XVIII of the Social Security Act;
> (E) A dependent child ceasing to be a dependent child under the generally applicable requirements of the plan; or
> (F) A proceeding in a case under Title 11, United States Code, commencing on or after July 1, 1986, with respect to the employer from whose employment the covered employee retired at any time.[139]

For a covered employee who is not a common law employee, a termination of employment for purposes of determining a qualifying event means termination of the relationship which gives rise to the individual's treatment as a covered employee.[140] In order to be a qualifying event, the event must cause the covered employee, the covered employee's spouse or the covered employee's dependent child to lose coverage under the plan.[141] If neither the covered employee nor the spouse or dependent child of the covered employee will lose coverage before the end of what would be the maximum coverage period, then the event which results in a loss of coverage is not a qualifying event.[142]

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[138] Prop. Treas. Reg. § 1.162-26 Q&A-17(c)(2), 52 Fed. Reg. at 22,716.

[139] I.R.C. § 4980B(f)(3) (1994).

[140] Prop. Treas. Reg. § 1.162-26 Q&A-18(b), 52 Fed. Reg. at 22,716.

[141] Prop. Treas. Reg. § 1.162-26 Q&A-18(c), 52 Fed. Reg. at 22,716. To "lose coverage" means to cease to be covered under the same terms and conditions as

Where an employee covered by a group health plan terminates employment, and as of the date of separation is given three months of employer-paid coverage under the same terms and conditions as before the date of separation, the termination of employment is a qualifying event.[143] Where a married employee retires and is given identical coverage for life, but the spousal coverage under the group health plan will not be continued beyond six months unless premiums are then paid by the employee or spouse, the employee will lose coverage six months after the employee's retirement when the premium requirement takes effect. Therefore, the retirement is a qualifying event and the spouse must be given an opportunity to elect COBRA continuation coverage.[144] Where a covered employee is married and both the covered employee and the covered employee's spouse are covered by a group health plan maintained by the employer, and the individuals are divorced resulting in loss of coverage by the spouse under the terms of the plan, the divorce is a qualifying event.[145] If the spouse elects COBRA continuation coverage and then remarries during the period of COBRA continuation coverage, the new spouse of the former spouse may become covered under the plan; however, in the event of the former spouse's later death or divorce from the new spouse, the death or divorce will not be a qualifying event because the former spouse is not a covered employee.[146]

The facts surrounding a termination or reduction of hours, other than gross misconduct, are irrelevant.[147] A voluntary termination or discharge of an employee, a strike or walk-out,

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in effect immediately before the qualifying event. *Id.*

[142] *Id.*

[143] Prop. Treas. Reg. § 1.162-26 Q&A-18(e)(1), 52 Fed. Reg. at 22,716.

[144] Prop. Treas. Reg. § 1.162-26 Q&A-18(e)(2), 52 Fed. Reg. at 22,716.

[145] Prop. Treas. Reg. § 1.162-26 Q&A-18(e)(3), 52 Fed. Reg. at 22,716.

[146] *Id.*

[147] Prop. Treas. Reg. § 1.162-26 Q&A-19, 52 Fed. Reg. at 22,716.

or a layoff may constitute a qualifying event if such events result in a loss of coverage.[148] If an employee is allowed to resign to avoid being terminated for gross misconduct, the employer and the insurer may not deny COBRA benefits.[149] An event that occurs while a group health plan is not subject to COBRA is not a qualifying event.[150] Therefore, if the plan later becomes subject to COBRA, it does not have to provide COBRA election rights to anyone whose coverage ends as a result of such event.[151]

F. Continuation Coverage

The Code defines "continuation coverage" by specifying the type of benefit coverage required, the period of coverage required, and the premium requirements.[152] Each qualified beneficiary losing coverage must be offered an opportunity to elect continuation of the group health plan coverage that he or she received immediately before the qualifying event.[153]

1. Type of Coverage

The type of required benefit coverage must be identical to the type of coverage provided to similarly situated beneficiaries who have not experienced a qualifying event.[154] When coverage is modified for any group of similarly situated beneficiaries, the coverage must be modified for qualified beneficiaries.[155]

A qualified beneficiary who, immediately before the qualifying event, is covered by a plan that provides both core coverage[156] and non-core coverage[157] must be able to elect either the coverage that he or she had immediately before the qualifying event or the core coverage only.[158] However, there are two exceptions to this rule.[159] First, if the applicable premium for core coverage is at least ninety-five percent of the applicable premium for core coverage and non-core coverage combined, the plan does not have to offer qualified beneficiaries the opportunity to elect core coverage only.[160] Second, if the employer maintaining the group health plan that includes non-core coverage also maintains at least one other group health plan for similarly situated active employees that does not provide any non-core coverage, the plan that includes non-core coverage does not have to offer a qualified beneficiary an opportunity to elect core coverage only.[161] Instead, the qualified beneficiary must be offered the opportunity to elect coverage under any other group health plan maintained by the employer for similarly situated active employees.[162]

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[148] *Id.*

[149] Conery v. Bath Assocs., 803 F. Supp. 1388, 1396 (N.D. Ind. 1992).

[150] Prop. Treas. Reg. § 1.162-26 Q&A-21, 52 Fed. Reg. at 22,725.

[151] *Id.*

[152] I.R.C. § 4980B(f)(2).

[153] *Id.* § 4980B(f)(1).

[154] *Id.* § 4980B(f)(2)(A).

[155] *Id.*

[156] The term "core coverage" is defined as all of the coverage that a qualified beneficiary was receiving under the group health plan immediately before a qualifying event that gives rise to COBRA election rights, other than non-core cover-

If non-core coverage is provided under a separate plan independent of the core plan, a qualified beneficiary who was covered under both plans will have separate election rights to each plan.[163] A qualified beneficiary who is covered by a single plan providing both core coverage and non-core coverage does not have to be offered the opportunity to elect only non-core coverage.[164] However, if immediately before the qualifying event, the qualified beneficiary is covered by a group health plan providing non-core coverage but no core coverage, the qualified beneficiary must be offered the opportunity to contin-

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age. Prop. Treas. Reg. § 1.162-26 Q&A-25, 52 Fed. Reg. at 22,726.

[157] The term "non-core coverage" is defined as coverage for vision and dental benefits unless coverage for vision or dental benefits must be provided under applicable law. Prop. Treas. Reg. § 1.162-26 Q&A-25, 52 Fed. Reg. at 22,726.

[158] Prop. Treas. Reg. § 1.162-26 Q&A-24(a), 52 Fed. Reg. at 22,726.

[159] *Id.*

[160] Prop. Treas. Reg. § 1.162-26 Q&A-24(b), 52 Fed. Reg. at 22,726.

[161] Prop. Treas. Reg. § 1.162-26 Q&A-24(c), 52 Fed. Reg. at 22,726.

[162] *Id.*

[163] Prop. Treas. Reg. § 1.162-26 Q&A-26, 52 Fed. Reg. at 22,716.

[164] Prop. Treas. Reg. § 1.162-26 Q&A-27, 52 Fed. Reg. at 22,727. The coverages remain independent so that a qualified beneficiary will be able to elect coverage under the non-core plan only and under the core plan only. *Id.*

ue that non-core coverage.[165] In addition, such an individual generally will not have to be given the opportunity to elect core coverage.[166]

2. Period of Coverage

The Code provides that coverage must extend, at minimum, from the date of the qualifying event through the earliest of the following: (1) the last day of the maximum required period;[167] (2) the first day for which timely payment is not made to the plan on behalf of the qualified beneficiary; (3) the date upon which the employer ceases to maintain any group health plan to any employee; (4) the first date the qualified beneficiary is covered under any other group health plan with no pre-existing condition limitation or exclusion that is not maintained by the employer; and (5) the date that the qualified beneficiary becomes entitled to Medicare benefits under Title XVIII of the Social Security Act.[168] A group health plan is not prohibited from providing coverage that continues beyond the end of the maximum coverage period.[169] However, the end of the maximum required period is measured from the date of the qualifying event even if the qualifying event does not cause a loss of coverage until a later date.[170]

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[165] *Id.*

[166] *Id.*

[167] Federal regulations define "maximum required period" as:

> (a) If the qualifying event is loss of coverage due to a Title XI bankruptcy of the employer, the date of the death of the covered employee or, in the case of the surviving spouse or dependent children of the covered employee, the period of coverage shall extend to 36 months after the date of the death of the covered employee;
> (b) In the case of any qualifying event other than termination of employment or reduction of hours or a Title XI bankruptcy of the employer, the maximum required period of coverage shall end 36 months after the date of the qualifying event;
> (c) In the event a covered employee becomes entitled to Medicare and within 18 months of such entitlement separates from service or has a reduction in hours, the period of coverage for qualified beneficiaries other than the covered employee for such event or any subsequent qualifying event terminates 36 months from the date the covered employee became entitled to Medicare benefits; and
> (d) Where a qualified beneficiary is determined under Title II or XVI of the Social Security Act to have been disabled at any time during the first 60 days of continuation coverage, each 18 month period referred to in (1) will be extended to 29 months (with respect to all qualified beneficiaries whose status as a qualified beneficiary is with respect to the same qualifying event) if the necessary notices, as discussed later, are provided.

Prop. Treas. Reg. § 54.4980B-1, 63 Fed. Reg. at 711.

When a qualified beneficiary has other group health plan coverage or Medicare entitlement, the period of COBRA coverage ends on the date the qualified beneficiary first becomes covered under any other group health plan not containing an exclusion or limitation regarding a pre-existing condition.[171] If a qualified beneficiary becomes entitled to Medicare benefits because of a disability occurring within sixty days of continuation coverage, then the period of COBRA coverage ends on the month beginning more than thirty days after the final determination that the qualified beneficiary is no longer disabled.[172] A group health plan may provide that the period of continuation coverage begins with the date of coverage loss and that the applicable notice period begins with the date of coverage loss.[173]

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[168] I.R.C. § 4980B(f)(2)(B) (West Supp. 1997). If the qualifying event is termination of employment or reduction of hours, the maximum required period for coverage is eighteen months after the date of the qualifying event. In the event of a qualifying event other than a Title XI bankruptcy of the employer during the eighteen months, the maximum required period will be extended to end thirty-six months after the date of termination of employment or reduction of hours. *Id.*

[169] Prop. Treas. Reg. § 1.162-26 Q&A-39, 52 Fed. Reg. at 22,716.

[170] *Id.*

[171] I.R.C. § 4980B(f)(2)(B)(iv). COBRA coverage does not end upon entitlement to Medicare benefits if the qualified beneficiary is a retiree or widow whose qualifying event is bankruptcy of the employer. *See id.* § 4980B(f)(2)(B)(i)(III); *id.* § 4980B(g)(1)(D).

[172] *Id.* § 4980B(f)(2)(B)(v). The final determination that the beneficiary is no longer disabled is determined under the rules set forth in Title II or Title XVI of the Social Security Act. *Id.*

[173] *Id.* § 4980B(f)(8).

3. *Premiums and Deductibles*

A group health plan may require payment of a premium for continuation coverage.[174] However, the premium may not exceed 102% of the applicable premium[175] for the period and may, at the election of the payor, be made in monthly installments.[176] Premiums may not exceed 150% for any month after the eighteenth month of continuation coverage for qualified beneficiaries who are determined to be disabled at any time during the first sixty days of continuation coverage.[177]

If the applicable premium increases, a plan may increase the premium for COBRA continuation coverage.[178] However, the applicable premium for each determination period must be computed and fixed by the plan before the determination period begins.[179] The determination period is any twelve month period selected by the plan applied consistently from year to year.[180]

The Code defines "timely payment" for a period of COBRA continuation coverage as a payment made to the plan within thirty days after the first day of the period.[181] However, payment made by a later date is also considered timely if, the terms of the plan allow covered employees or qualified beneficiaries to make payment at the later date.[182] A payment made on a later date is considered timely if, under the terms of an arrangement between the employer and an insurance company, HMO, or other entity providing plan benefits, the employer is allowed to pay for coverage of similarly situated employees at the later date.[183]

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[174] *Id.* § 4980B(f)(2)(C).

[175] The Code defines "applicable premium" as the cost to the plan of identical coverage for similarly situated beneficiaries to whom a qualifying event has not occurred. *Id.* § 4980B(f)(4). For self-insured plans, the applicable premium equals the reasonable estimate of the cost of providing the coverage for similarly situated beneficiaries and is determined on an actuarial basis which takes into account factors prescribed under regulations. *Id.* § 4980B(f)(4)(B)(i). A plan administrator may elect to determine the applicable premium based on past cost. *Id.* § 4980B(f)(4)(B)(ii). The determination of any applicable premium is made for a period of twelve months and is made before the beginning of the period. *Id.* § 4980B(f)(4)(C).

[176] *See id.* § 4980B(f)(2)(C).

[177] Prop. Treas. Reg. § 54.4980B-1, 63 Fed. Reg. at 711.

[178] Prop. Treas. Reg. § 1.162-26 Q&A-45, 52 Fed. Reg. at 22,730.

[179] *Id.*

[180] *Id.* Each qualified beneficiary does not have a separate determination period beginning on the date the COBRA continuation coverage begins for that qualified beneficiary. *Id.*

[181] Prop. Treas. Reg. § 1.162-26 Q&A-48(b), 52 Fed. Reg. at 22,731.

Qualified beneficiaries electing COBRA continuation coverage are generally subject to the same deductibles as similarly situated employees for whom a qualifying event has not occurred.[184] The specific requirements concerning deductibles are as follows:

> (a) If a qualified beneficiary's COBRA continuation coverage begins before the end of the prescribed period for accumulating amounts toward deductibles, the qualified beneficiary must retain credit for expenses incurred toward those deductibles before the beginning of COBRA continuation coverage as though the qualifying event had not occurred;
> (b) If a deductible is computed separately for each individual receiving coverage under the plan, each individual's remaining deductible amount on the date that continuation coverage begins is equal to that individual's remaining amount immediately before that date;
> (c) If a deductible is computed on a family basis, the deductible for each new family unit after the beginning of the continuation coverage. . .is equal to the family unit's remaining deductible amount. . .immediately before that date;
> (d) [Where] a single deductible is prescribed for core coverage and non-core coverage and a qualified beneficiary electing COBRA continuation coverage elects to receive core coverage only, the treatment of expenses for non-core coverage depends on when the expenses were incurred before the beginning of the continuation coverage. . .must continue to be counted toward satisfaction of the deductible, but such expenses need not be counted if they were incurred after the beginning of

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[182] *Id.*

[183] *Id.*

[184] Prop. Treas. Reg. § 1.162-26 Q&A-45, 52 Fed. Reg. at 22,730.

the continuation coverage.[185]

Plan limits, such as the maximum number of hospital days, dollar amount of reimbursable expenses, and limits that are in the nature of deductibles, such as a co-payment limit or a catastrophic limit, are treated in the same way as deductibles.[186]

4. *Insurability and Conversion Options*

Continuation coverage may not be conditioned upon lack of evidence of insurability.[187] When continuation coverage expires at the end of the maximum required period, the plan must allow the qualified beneficiary the option of enrollment under a conversion plan otherwise generally available.[188]

G. *Notice Requirements*

COBRA requires employers, plan administrators, and individuals seeking coverage to file certain notices.[189] A group health plan must provide written notice of COBRA continuation rights to each covered employee and their spouse.[190] An employer must notify the plan administrator of qualifying events such as death, termination of service, entitlement to Medicare, or bankruptcy of the employer within thirty days of the qualifying event.[191] In addition, covered employees or qualified beneficiaries must notify the plan administrator of qualifying events such as divorce, legal separation, or the ceasing of a dependent child to be a dependent within sixty days of the qualifying event.[192]

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[185] Prop. Treas. Reg. § 1.162-26 Q&A-28, 52 Fed. Reg. at 22,716.

[186] Prop. Treas. Reg. § 1.162-26 Q&A-29, 52 Fed. Reg. at 22,716.

[187] I.R.C. § 4980B(f)(2)(D).

[188] *Id.* § 4980B(f)(2)(E).

[189] *See id.* § 4980B(f)(6). The Department of Labor has issued a sample COBRA notice.

[190] *Id.* § 4980B(f)(6)(A). The written notice must be provided at the time of commencement of coverage under the plan. *Id.*

[191] *Id.* § 4980B(f)(6)(B). Multi-employer plans may extend the time for giving notice of qualifying events beyond the thirty-day period. *Id.*

[192] I.R.C. § 4980B(f)(6)(C). Each qualified beneficiary who is determined to have been disabled at any time during the first sixty days of continuation coverage is

A group health plan may provide that the notice period applicable to an employer commences on the date coverage is lost and that the period of extended coverage commences on the date coverage is lost.[193] A plan administrator must notify a qualified beneficiary within fourteen days of receiving notice from an employer concerning death of the covered employee, termination of service of the covered employee, entitlement to Medicare, or bankruptcy by the employer.[194] An employer who is the plan administrator has forty-four days after the occurrence of the qualifying event to issue the required notices to qualified beneficiaries.[195] When a qualifying event is divorce, legal separation, or a child ceasing to be a dependent of the covered employee, the plan administrator must notify any qualified beneficiary within fourteen days of receiving notice from the covered employee.[196] Group health plans subject to continuation coverage requirements under ERISA, the Code, or the Public Health Service Act are required to notify each qualified beneficiary who has elected continuation coverage of the amendments made by HIPAA or the Public Health Service Act.[197]

H. Election Period

Any election of continuation coverage by a qualified beneficiary who is the covered employee or their spouse is deemed an election of continuation coverage for all other qualified beneficiaries who would lose coverage because of the qualifying event.[198] If there is a choice among types of coverage under

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responsible for notifying the plan administrator of the determination within sixty days after the date of the determination, and is also responsible for notifying the plan administrator within thirty days of the date of any final determination that the qualified beneficiary is no longer disabled. *Id.* Any qualified beneficiary may provide the plan administrator a copy of the determination of disability. *Id.*

[193] *Id.* § 4980B(f)(8).

[194] *Id.* § 4980B(f)(6).

[195] DOL Information Letter, dated April 11, 1995.

[196] I.R.C. § 4980B(f)(6).

[197] HIPAA § 421(d), Pub. L. No. 104-191 (1996). The changes are effective January 1, 1997, regardless of whether the qualifying event occurred before, on or after such date. HIPAA § 421(e), Pub. L. No. 104-191.

[198] I.R.C. § 4980B(f)(5)(B). The Code defines "election period" as:

the plan, each qualified beneficiary is entitled to make a separate selection of which type of coverage will continue.[199] If a qualified beneficiary waives COBRA continuation coverage during the election period, he may revoke the waiver at any time before the end of the election period.[200]

I. Sanctions For Failure To Comply With COBRA Requirements

The Code imposes a tax for the failure of a group health plan to meet COBRA continuation requirements.[201] The individuals liable for the tax imposed on such a failure include the employer and the plan.[202] In addition, each person responsible for administering or providing benefits under the plan and whose act or failure to act causes the non-compliance is subject to the tax liability.[203] However, a person is liable only if the person assumed responsibility for the performance of the act pursuant to a written contract.[204] A person is deemed responsible for the failure if they provide coverage under a group health plan for similarly situated beneficiaries and they receive

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> (i) begin[ning] not later than the date on which coverage terminates under the plan by reason of a qualifying event,
> (ii) is of at least 60 days' duration, and
> (iii) ends not earlier than 60 days after the latter of
>   (I) the date described in clause (i), or
>   (II) in the case of any qualified beneficiary who receives notice under paragraph (6)(D), the date of such notices.

Id. § 4980B(f)(5)(A).

[199] *Id.* § 4980(f)(5)(B).

[200] Prop. Treas. Reg. § 1.162-26 Q&A-35, 52 Fed. Reg. at 22,716. If the qualified beneficiary later revokes the waiver, coverage is not required to be retroactive. *Id.* Such waivers and revocations of waivers are considered made on the date that the waivers and revocations are sent to the employer or plan administrator as applicable. *Id.*

[201] I.R.C. § 4980B(a).

[202] *Id.* § 4980B(e)(1). The employee may be liable in the case of a plan other than a multi-employer plan. *Id.* § 4980B(e)(1)(A)(i). The plan may be liable in the case of a multi-employer plan. *Id.* § 4980B(e)(1)(A)(ii).

[203] *Id.* § 4980B(e)(1)(B).

[204] *Id.* § 4980B(e)(2)(A).

a written request for continuation coverage.[205] A person will be deemed responsible for the failure if they receive the written request from a qualified beneficiary seeking continuation coverage pursuant to a divorce or the ceasing of a child to be dependent.[206]

The amount of tax imposed on a person for failure to comply with Code requirements is $100 for each day in the noncompliance period.[207] The Code defines "noncompliance period" as the period beginning on the date the failure first occurs and ending when the failure is corrected or six months after the last day in the applicable period, whichever is earlier.[208] If the person is liable because they are responsible for administering or providing benefits under the plan and their act or failure to act caused the non-compliance, then the non-compliance period for that person does not begin until the forty-fifth day after the employer, plan administrator, or qualified beneficiary submits to the responsible individual a written request that continuation coverage be provided.[209]

No tax liability arises if the failure was due to reasonable cause and is corrected within a thirty-day period beginning when an individual subject to tax liability knew or should have known of the failure.[210] Similarly, no tax is imposed if the potentially liable party establishes to the satisfaction of the Secretary of the Treasury that none of the potentially liable persons knew or should have known of the failure.[211] In the case of one or more failures with respect to a qualified beneficiary which are not corrected before the date a notice of examination of income tax liability is sent to the employer, and which occurred or continued during the period under examination, the tax imposed by reason of such failures will not be less than $2,500 or the amount which would be imposed under the general $100 a day rule.[212] In the event the violations for a year are more than de minimis, the $2,500 limit is increased to $15,000.[213]

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[205] *Id.* § 4980B(e)(2)(B).

[206] I.R.C. § 4980B(e)(2)(B).

[207] *Id.* § 4980B(b)(1).

[208] *Id.* § 4980B(b)(2). The maximum amount of tax imposed for failures concerning one qualified beneficiary is $100 per day. If there is more than one beneficiary qualifying by the same event, the maximum amount of tax imposed for this multiple failure is $200 per day.

[209] *Id.*

[210] *Id.* § 4980B(c)(2).

[211] I.R.C. § 4980B(c)(1). The Secretary of the Treasury may waive part or all of the tax to the extent the payment of the tax would be excessive relative to the failure involved. *Id.* § 4980B(c)(5).

Where a failure to comply is due to reasonable cause, in the case of a single employer plan, the tax to be imposed for failures during the taxable year of the employer will not exceed the amount equal to the lesser of ten percent of the aggregate amount paid or incurred by the employer during the preceding taxable year for the group health plans; or $500,000.[214] If the persons who are treated as a single employer for purposes of this limitation have different taxable years, the taxable years taken into account will be determined by principles similar to the principles under Code § 1561.[215]

For a multi-employer plan, the tax to be imposed for failures during the taxable year of the trust forming part of the plan will not exceed the amount equal to the lesser of ten percent of the amount paid or incurred by such trust during the taxable year to provide medical care directly or through insurance, reimbursement or otherwise; or $500,000.[216] For purposes of this limitation, all plans of which the same trust forms a part will be treated as one plan.[217] If an employer is assessed a tax by reason of a failure with respect to a multi-employer plan, the limit is determined under the rules for a single employer plan.[218]

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[212] *Id.* § 4980B(b)(3)(A).

[213] *Id.* § 4980B(b)(3)(B).

[214] *Id.* § 4980B(c)(4)(A)(i).

[215] *Id.* § 4980B(c)(4)(A)(ii).

[216] I.R.C. § 4980B(c)(4)(B)(i).

[217] *Id.* § 4980B(c)(4)(B)(i).

[218] *Id.* § 4980B(c)(4)(B)(ii).

IV. Family and Medical Leave Act

Under the Family and Medical Leave Act (FMLA) of 1993, covered employers[219] must provide eligible employees with up to twelve weeks of unpaid job protected leave each year for the birth or adoption of a child or to care for a newborn or a newly adopted child or the "serious health condition" of the employee or the employee's children, spouse or parents.[220] To be eligible, a person must have been employed for at least twelve months and must have at least 1,250 hours of service with the employer during that period.[221] FMLA requires covered employers to allow eligible employees who take leave to continue coverage under group health plans on the same terms and conditions applicable to active employees.[222]

The Internal Revenue Service has issued guidelines clarifying how the FMLA and COBRA continuation interact when an employee does not return at the end of FMLA leave.[223] The Internal Revenue Service considers compliance with this notice as good-faith compliance with COBRA's statutory requirements until the regulations are finalized.[224] Under this notice, there is a qualifying event if:

> (1) an employee (or the spouse or a dependent child of the employee) is covered on the day before the first day of FMLA leave (or becomes covered during the FMLA leave) under a group health plan of the employee's employer, (2) the employee does not return to employment with the employer at the end of the FMLA leave, and (3) the employee (or the spouse or a dependent child of the employee) would, in the absence

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[219] The FMLA applies to employers with fifty or more employees, or employer facilities that employ fifty or more employees within a seventy-five mile radius for each working day during each of twenty or more calendar work weeks in the current or preceding calendar year. 29 C.F.R. § 825.110(a)(3) (1997).

[220] 29 U.S.C. § 2612(a)(1) (1994).

[221] 29 C.F.R. § 825.110(c).

[222] 29 U.S.C. § 2614(c)(1).

[223] I.R.S. Notice 94-103, 1994-2 C.B. 569.

[224] *Id.* at 571.

> of COBRA continuation coverage, lose coverage under the group health plan. . . before the end of what would be the maximum coverage period.[225]

If an employee fails to return after FMLA leave, an employer has the right to recover health insurance premiums that it has paid on behalf of the employee; however, the employer must give the employee and their dependents the opportunity to elect COBRA continuation coverage regardless of whether the employee repays any amount due the employer.[226]

The COBRA notice rules apply where an employee has experienced an FMLA qualifying event.[227] The employer must notify the plan administrator of the qualifying event within thirty days after FMLA leave ends or, if later, within thirty days of the date coverage is lost.[228]

A group health plan is defined for purposes of FMLA as any plan providing health care to employees, former employees or their families. The plain language of FMLA limits its scope to plans required to provide COBRA coverage.[229] However, final regulations state that FMLA does not apply to a plan where employees purchase individual health insurance polices provided that:

> (1) no contributions are made by the employer;
> (2) participation in the program is completely voluntary for employees;
> (3) the sole functions of the employer with respect to the program are, without endorsing the programs, to permit the

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[225] *Id.* at 570.

[226] *Id.* An employer may offset premiums owed against other amounts still due the employee, such as bonus payments and other payments, but not wages which have previously been earned. 29 C.F.R. § 825.213(f). Although the regulations appear to allow offset against profit sharing payments, ERISA and the Code require an employee to consent to offset against amounts due an employee from an ERISA covered pension plan or qualified retirement plan. ERISA § 206(d), 29 U.S.C. § 1056(d)(1) (1994); I.R.C. § 401(a)(13) (West 1989 & Supp. 1997).

[227] *Id.*

[228] *Id.*

[229] 29 U.S.C.A. § 2614(c) (West Supp. 1997); 29 C.F.R. §§ 825.209(a), 825.800 (1996).

> insurer to publicize the program to employees, to collect premiums through payroll deductions and to remit them to the insurer;
> (4) the employer receives no consideration in the form of cash or otherwise in connection with the programs, other than reasonable compensation excluding any profit, for administrative services actually rendered in connection with payroll deduction; and
> (5) the premium changed with respect to such coverage does not increase in the event the employment relationship terminates.[230]

Premiums charged to an employee on FMLA leave may be charged at the same rates as those charged for active employees.[231] The employer may collect premiums by: (1) requiring payment at the same time as it would be made by payroll deduction, (2) requiring payment at the same time as COBRA premiums would be paid, (3) permitting prepayment prior to the beginning of a leave, (4) permitting payment in accordance with existing leave policies, or (5) any other method agreed upon by an employer and employee.[232] An employer can terminate health coverage during FMLA leave for failure to timely pay premiums.[233] However, the regulations require a thirty day grace period for employee health coverage premiums.[234] If the employer continues employee coverage at its own cost, the employer may recover the employee portion of the premiums it paid during the FMLA leave.[235]

An employer may recover its share of health coverage premiums paid during unpaid FMLA leave if the employee does not return to work.[236] An employee is deemed to have returned to work when he returns for at least thirty calendar days or when he retires either immediately upon termination of the FMLA leave period or within thirty calendar days after returning to work.[237] The employer may not recover premiums if the employee uses paid leave during FMLA leave.[238] With respect to a self-insured employer, the coverage is limited to the employer's share of allowable premiums as would be calculated under COBRA, excluding the 2% fee for administrative costs.[239] An employer cannot recover its share of the premiums if the employee's failure to return to work is because of continuation, recurrence or onset of a serious health condition that would entitle the employee to FMLA leave.[240] The employer may require medical certification of the individual's serious health condition and may recover premiums if the employee does not provide the certification within thirty days of the request.[241]

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[230] 29 C.F.R. § 825.209(a).

[231] 29 C.F.R. § 825.210(a). The employer may not charge the employee for administrative costs. 29 C.F.R. § 825.210(c).

[232] *Id.* The employee may prepay premiums pursuant to a cafeteria plan. *Id.*

[233] *Id.* § 825.212(a)(1).

[234] *Id.*

[235] *Id.* § 825.212(b).

[236] 29 C.F.R. § 825.213(a).

A notice explaining FMLA provisions and procedures for filing complaints must be posted at the work place where it can be seen by applicants and employees.[242] In satisfying this notice requirement, employers may duplicate the notice contained as an appendix to the regulations or may obtain a notice from the local office of the Wage and Hour Division of the U.S. Department of Labor.[243] There is a $100 penalty for violation of the notice requirement.[244]

When an employee provides notice of the need for FMLA leave, the employer must provide the employee with written notice explaining any requirement that the employee pay premiums to maintain health benefits and the arrangements for making the payments.[245] The notice must also explain the employee's potential liability for payment of health insurance premiums paid by the employer if the employee fails to return to work after the leave.[246] The employer must also notify an employee on FMLA leave of his opportunity to add or change plans or benefits as provided to active employees.[247]

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[237] *Id.* § 825.213(c).

[238] *Id.*

[239] *Id.* § 825.213(e).

[240] *Id.* § 825.213(a)(3). Circumstances beyond the employee's control include: (1) an employee who chooses to stay home with a newborn child with a serious health condition; (2) the unexpected job location transfer of the employee's spouse more than seventy-five miles from the employee's worksite; (3) the necessity of an employee to care for the employee's relative who has a serious health condition; or (4) a key employee's decision not to return to work upon being notified of the employer's intent to deny the employee's job restoration because of substantial economic injury to the employer's operations that would result from restoration. *Id.* 825.213(a)(2).

[241] 29 C.F.R. § 825.213(a)(3).

[242] *Id.* § 825.300(a).

[243] *Id.*

[244] *Id.* § 825.300(b).

Upon the employee's return from FMLA leave, the employer must reinstate the employee's coverage without any qualifying period, physical examination, or exclusion of pre-existing conditions.[248] This obligation is not imposed on the insurer; therefore, where the employee chooses not to pay his portion of the premium, the employer should retain coverage at its own cost or confirm with its group insurance carrier whether that coverage may be reinstated upon the employee's return. Subject to COBRA, FMLA obligations cease when:

> 1. The employment relationship would have terminated even if the employee had not taken FMLA leave;
> 2. The employee informs the employer that he intends not to return from leave;
> 3. The employee fails to return after exhausting his FMLA leave entitlement; or
> 4. The employee fails to make a premium payment for more than thirty days, and the employer notifies the employee at least fifteen days before coverage is to cease that coverage will be dropped unless payment is received.[249]

Each employer must develop procedures to keep records of information for at least three years, which should include the amount of premiums paid on behalf of employees.[250]

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[245] *Id.* § 825.301(b)(1).

[246] 29 C.F.R. § 825.301(b)(1)(viii).

[247] *Id.* § 825.209(c)-(d).

[248] *Id.* § 825.209(e).

[249] *Id.* § 825.212.

The Internal Revenue Service has issued proposed regulations regarding the effect of FMLA on cafeteria plans.[251] The proposed regulations do not interpret the FMLA but provide guidance on the cafeteria plan rules applicable in the FMLA context. The proposed regulations provide that an employee on FMLA leave may revoke an existing election of group health plan coverage, including coverage under a flexible spending arrangement (FSA) pursuant to a cafeteria plan for the remaining portion of the coverage period.[252] Pursuant to FMLA, a returning employee may be permitted to reinstate group health coverage, including coverage under a health FSA provided under a cafeteria plan, if the employee's group health plan coverage terminated while on FMLA leave.[253] The employee may also revoke elections because of changes in family status, or significant cost or coverage changes imposed by a third-party provider, under the same terms and conditions available to employees participating in the cafeteria plan who are not on FMLA leave.[254]

An employee who takes FMLA leave may revoke an election of non-health benefits under the cafeteria plan to the same extent as employees taking non-FMLA leave.[255] In certain cases, an employer should continue an employee's non-health benefits under the employer's cafeteria plan while the employee is on FMLA leave to ensure that the employer can meet its responsibility to provide equivalent benefits to the employee upon return from unpaid FMLA leave.[256] The cafeteria plan must permit an employee whose coverage terminated while on FMLA leave (either by revocation or for nonpayment of premiums) to be reinstated in the cafeteria plan upon return from

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[250] *Id.* § 825.500(b)-(c).

[251] Prop. Treas. Reg. § 1.125-3 Q&A-1, 62 Fed. Reg. at 60,165.

[252] *Id.*

[253] *Id.*

[254] *Id.*

[255] Prop. Treas. Reg. § 1.125-3 Q&A-7, 62 Fed. Reg. at 60,165.

[256] *Id.*

FMLA leave.[257]

An employee making premium payments under a cafeteria plan who chooses to continue group health plan coverage while on FMLA leave is responsible for the share of group health premiums that the employee was paying during employment.[258] An employer must continue to contribute the portion of the premium that the employer was paying before the employee commenced FMLA leave.[259]

On a nondiscriminatory basis, a cafeteria plan may offer one or more of three payment options to an employee who continues group health plan coverage while on unpaid FMLA leave.[260] Under a pre-pay option, a cafeteria plan may permit an employee to pay the amounts due for the FMLA leave before beginning the leave period.[261] However, the employer may not require an employee to pre-pay the amounts due for the leave.[262] Under a "pay as you go" option, employees may pay their share of their premiums on the same schedule as payments would be made if the employee were not on leave.[263] The third option is that the payments may be made on any schedule permitted by the Department of Labor regulations, including the schedule for paying premiums for COBRA continuation coverage.[264]

Employee contributions are generally made by the employee on an after-tax basis. Under the "catch-up" option, an employer who continues to provide group health coverage to an employee who does not pay premiums during FMLA leave is permitted to utilize the catch-up option to recoup the employee's share of premium payments.[265] Where an employee elects to use the catch-up option, the employee and employer must agree in advance of the coverage period that (1) the employee elects to continue health coverage, (2) the employer will assume responsibility for advancing payment of the premiums on the employee's behalf, and (3) the advanced amounts must be paid by the employee when the employee returns from FMLA leave.[266]

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[257] Prop. Treas. Reg. § 1.125-3 Q&A-7, 60 Fed. Reg. at 66,232.

[258] Prop. Treas. Reg. § 1.125-3 Q&A-2, 60 Fed. Reg. at 66,230. This includes amounts paid under a salary reduction agreement.

[259] *Id.*

[260] Prop. Treas. Reg. § 1.125-3 Q&A-3, 60 Fed. Reg. at 66,230.

[261] *Id.*

[262] *Id.* Contributions under the pre-pay option may be made on a pre-tax salary reduction basis from any taxable compensation, including any cashed-out, unused sick days or vacation days. *Id.* The compensation will not be included in the employee's gross income, provided that all cafeteria plan requirements are satisfied. *Id.* The contributions under the pre-pay option may also be made on an after-tax basis. *Id.*

[263] Prop. Treas. Reg. § 1.125-3 Q&A-3, 60 Fed. Reg. at 66,231.

[264] *Id.* Contributions may be made on a pre-tax basis to the extent that contributions are made from taxable compensation that is due the employee during the leave period and provided that all cafeteria plan requirements are satisfied. *Id.*

Cafeteria plans may offer one or more of these payment options but the pre-pay option cannot be the only option offered.[267] The catch-up option can be the only option offered to employees on FMLA leave only if the catch-up option is the only option offered to employees on non-FMLA leave without pay.[268] The plan cannot offer employees on FMLA leave a choice of either the pre-pay option or the catch-up option without also offering the pay-as-you-go option if the pay-as-you-go option is offered to employees on non-FMLA leave without pay.[269]

An employer may voluntarily waive, on a non-discriminatory basis, the requirement that employees who elect to continue health coverage while on FMLA leave pay the amounts the employees otherwise would be required to pay during the leave.[270] If an employee's FMLA leave is substituted paid leave and the employee continues group health plan coverage while on FMLA leave, the employee's share of the premiums must be paid by the method normally used during any other type of leave.[271] Contributions to a cafeteria plan during FMLA leave will not be included in an employee's gross income, provided that the plan complies with all cafeteria plan requirements.[272] A plan may not permit employees on FMLA leave to defer compensation from one cafeteria plan year to a subsequent cafeteria plan year.[273]

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[265] *Id.*

[266] *Id.* Payments may be made on a pre-tax salary reduction basis when the employee returns from the FMLA leave from any available taxable compensation. *Id.* Contributions under the catch-up option also may be made on an after-tax basis. *Id.*

[267] *Id.*

[268] Prop. Treas. Reg. § 1.125-3 Q&A-3, 60 Fed. Reg. at 66,231.

[269] *Id.*

[270] *Id.*

A health FSA offered under a cafeteria plan must conform to the rules that apply to cafeteria plan health benefits concerning employees on FMLA leave.[274] Thus, FMLA requires that an employee on FMLA leave be permitted to continue coverage under a health FSA while on FMLA leave.[275] The FMLA also requires the plan to permit the employee to be reinstated in the health FSA upon return from FMLA leave on the same terms as before taking the leave.[276]

The uniform coverage rule applies during an FMLA leave period as long as the employee continues health coverage.[277] As long as the employer continues coverage, the full amount of the elected coverage must be available to the employee at all times.[278] If an employee's coverage under a health FSA terminates while the employee is on FMLA leave, the employee is not entitled to receive reimbursements for claims incurred during the period of terminated coverage.[279] If the employee subsequently elects to be reinstated in a health FSA upon return from FMLA leave, the employee may not retroactively elect health FSA coverage for claims incurred during the period of terminated coverage.[280] An employee is not entitled to greater

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[271] Prop. Treas. Reg. § 1.125-3 Q&A-4, 60 Fed. Reg. at 66,231.

[272] Prop. Treas. Reg. § 1.125-3 Q&A-5, 60 Fed. Reg. at 66,231.

[273] *Id.*

[274] Prop. Treas. Reg. § 1.125-3 Q&A-6, 60 Fed. Reg. at 66,231.

[275] *Id.* An employee on FMLA leave may revoke an existing health FSA election for the remainder of the coverage period. *Id.*

[276] *Id.* Reinstatement is at the employee's option, and the employer may not require an employee whose coverage has terminated while on FMLA leave to reinstate coverage under a health FSA after returning from the leave. *Id.*

[277] Prop. Treas. Reg. § 1.125-3 Q&A-6(b)(1), 60 Fed. Reg. at 66,232.

[278] *Id.*

[279] *Id.*

[280] Prop. Treas. Reg. § 1.125-3 Q&A-6, 60 Fed. Reg. at 66,232. If an employee

FSA benefits than an employee who has been continuously working during the plan year.[281] An employee on FMLA leave has the right to revoke or change elections under the same terms and conditions that apply to employees participating in the cafeteria plan who are not on FMLA leave.[282]

V. MEDICARE AS SECONDARY PAYER

Under the "Medicare as Secondary Payer" (MSP) provisions, an employer's plan is required to pay on a primary basis, and Medicare is required to pay only on a secondary basis for those Medicare-eligible individuals who are otherwise eligible for health care under an employer's health plan.[283] This requirement is applicable to employees, their spouses, disabled employees, and certain individuals with End-Stage Renal Disease.[284]

The Health Care Financing Administration (HCFA) issued amendments to proposed regulations concerning Medicare's secondary payer status for certain Medicare eligible individuals who are also covered by a group health plan.[285] The regulations include provisions outlining: (1) how HCFA determines that a large group health plan does not conform to the requirements and prohibitions of the Medicare statute; (2) the appeals procedure respecting plans that HCFA finds to be nonconforming; (3) referral of nonconforming plans for possible imposition of the excise tax; and (4) the rules of recovery of conditional or

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elects to be reinstated in a health FSA upon return from FMLA leave, the employee's coverage for the remainder of the plan year is equal to the employee's election for the twelve-month period of coverage, or such shorter period prorated for the period during the FMLA leave for which no premiums were paid and reduced by prior reimbursements. *See id.*

[281] *See id.*

[282] *Id.* An employee who returns from an FMLA leave may make a new health FSA election for the remainder of the plan year since return from leave without pay constitutes a change in status and a change of family status under the employee's cafeteria plan. *Id.* However, such election must be consistent with the change in status or change of family status. *Id.*

[283] 42 U.S.C. § 1395y(b)(2) (1994).

[284] 42 U.S.C. § 1395y(b)(1)(A).

[285] 60 Fed. Reg. at 48,749.

mistaken Medicare payments.[286] The rules also clarify the interaction of the MSP rules and the continuation coverage requirements under COBRA.[287] The MSP rules provide that if HCFA must file suit for recovery of the primary payment, then HCFA is entitled to recover an amount equal to twice the amount of the primary Medicare payment.[288]

The final regulations clarify that the prohibition against an employer or other entity offering incentives to a Medicare eligible individual to not participate in a group health plan precludes offering Medicare beneficiaries an alternative to the employer's primary plan unless the beneficiary has primary coverage other than Medicare.[289] The regulations also centralize the anti-discrimination requirements and define what is meant by "taking into account" in the context of group health plans. [290]

The MSP rules define "similarly situated individuals" as other individuals enrolled or seeking to enroll in a group health plan.[291] If a plan makes benefit distinctions among various categories of persons unrelated to an individual's disability, such as length of service, job category, or marital status, then a plan may likewise make the same distinctions among Medicare entitled individuals whose plan coverage is based on current employment status.[292] A plan may pay benefits secondary to Medicare for an aged or disabled beneficiary who has current employment status if the plan coverage is provided under COBRA because of a reduction in hours of work.[293] A plan may terminate COBRA continuation coverage of an individual who becomes entitled to Medicare due to End-Stage Renal

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[286] *Id.*

[287] *Id.*

[288] 42 U.S.C. § 1395y(b)(2)(B)(ii).

[289] 42 C.F.R. § 411.103(a) (1997).

[290] *See id.* § 411.108(a).

[291] *Id.* § 411.101.

[292] *Id.* § 411.108(b)(1).

[293] *Id.* § 411.108(b)(2). Medicare is the primary payer with respect to the individual because while the individual has current employment status, the plan coverage is secondary by virtue of COBRA rather than by reason of current employment status. *Id.*

Disease when otherwise permitted under the COBRA rules.[294] The regulations further prohibit a plan from differentiating in the benefits it provides between individuals who have End-Stage Renal Disease and others involved in the plan on the basis of End-Stage Renal Disease or the need for dialysis.[295] The regulations incorporate procedures that HCFA must follow for determining that a particular plan does not conform to the MSP rules along with the consequences of nonperformance.[296]

Provisions are included in the Balanced Budget Act of 1997 which make permanent the requirement that large group health plans provide primary coverage for eighteen months after an individual becomes disabled, and for Medicare eligible individuals with End-Stage Renal Disease, the eighteen months is extended to thirty months.[297] Also, HCFA now has up to three years to recover amounts mistakenly paid by Medicare on a primary basis.[298]

VI. THE AMERICANS WITH DISABILITIES ACT

Among the protections provided by the Americans with Disabilities Act (ADA) is protection from discrimination in employee benefits because of disability.[299] An employer is not required to provide benefit coverage during ADA leave unless it provides coverage for employees without disabilities.[300] The ADA prohibits employers from entering into contracts or other arrangements with insurers or third-party administrators that have the effect of discriminating against the disabled.[301] The ADA prohibition against excluding or otherwise denying equal benefits to a qualified nondisabled person because the person has a relationship or association with a disabled individual may preclude an employer from denying employment to a potential employee with a disabled spouse or dependent even though the addition of those dependents will result in a significant additional health cost to the employer.[302]

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[294] 42 C.F.R. § 411.108(b)(3).

[295] *Id.* § 411.162.

[296] *Id.*

[297] Balanced Budget Act of 1997 § 4631, Pub. L. No. 105-33, 111 Stat. 486 (1997).

[298] Balanced Budget Act of 1997 § 4632, Pub. L. No. 105-33, 111 Stat. 486 (1997).

[299] *See* 29 C.F.R. § 1630.4(f) (1997).

[300] *See* 29 C.F.R. § 1630.4.

[301] 42 U.S.C. § 12112(b)(2) (1994). This provision could be interpreted to impose liability for discrimination on employers entering into such prohibited contracts or arrangements. *See id.*

Under the ADA, an employer may establish, sponsor, observe or administer the terms of a bona fide benefit plan based on underwriting risks consistent with state law regulating insurance.[303] This appears to allow the employer to develop and administer health benefit plans in accordance with accepted principles of risk assessment. The Equal Employment Opportunity Commission has issued Interim Enforcement Guidance on the application of the ADA to disability-based distinctions in employer health plans. Those guidelines include distinctions based on deafness, AIDS, schizophrenia, cancers, muscular dystrophy, kidney diseases or any condition that substantially limits a major life activity.

OBRA '93 changed the MSP rules to make them consistent with the rules for the working aged.[304] A Medicare beneficiary over age sixty-five will be treated as an employee only if he or she is currently working.[305] To make Medicare the primary payer, employers must submit the name, date of birth, sex, social security number, and health insurance claim number for the disabled employee to the Medicare contractor.[306] In addition, the employer must send a signed letter certifying that each identified disabled employee does not have group health plan coverage based on his or her own current employment status.

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[302] *Id.* § 12112(b)(4).

[303] 29 C.F.R. § 1630.16(f)(2).

[304] Omnibus Budget Reconciliation Act of 1993, Pub. L. No. 103-66, § 13561(e)(1), 107 Stat. 312, 595-96 (1993).

[305] Omnibus Budget Reconciliation Act § 13561(e)(1).

[306] *Id.*

VII. ADDITIONAL STANDARDS FOR GROUP HEALTH PLANS ADDED BY OBRA '93

A. *Medical Child Support Orders*

ERISA requires each group health plan to be amended by the first plan year beginning on or after January 1, 1997 to provide benefits in accordance with the applicable requirements of any qualified medical child support order.[307] The inclusion of orders pursuant to an administrative process require a plan amendment by the first day of the plan year beginning on or after January 1, 1997.[308] A "qualified medical child support order" is a medical child support order which creates or recognizes the existence of an alternate recipient's right to receive benefits under a group health plan, where the order includes certain information and restrictions on types or forms of benefit.[309] A qualified order must include the following information:

> (A) the name and last known mailing address (if any) of the participant and . . . alternate recipient covered by the order;
> (B) a reasonable description of the type of coverage to be provided by the plan to each such alternate recipient, or the manner in which [the] coverage is to be determined;
> (C) the period to which the order applies; and
> (D) each plan to which such order applies.[310]

Written procedures must be established for determining the qualified status of orders for each group health plan to determine whether the medical child support order is qualified to administer the provisions of the benefits under the order.[311] The procedures must:

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[307] ERISA § 609(a)(1), 29 U.S.C.A. § 1169(a)(1) (West Supp. 1997). A "medical child support order" is any judgment, decree, or order (including approval of a settlement agreement) issued by a court of competent jurisdiction (or through an administrative process with the force and effect of applicable state law) which provides health benefit coverage to such a child. 29 U.S.C.A. § 1169(a)(1). A "medical child support order" may also be provided for pursuant to a state domestic relations law and relates to benefits under the plan or pursuant to a law providing medical child support under Section 1908 of the Social Security Act. *Id.* § 1169(a)(4).

[308] Pub. L. No. 104-93 § 381(b).

[309] 29 U.S.C.A. § 1169(a).

[310] *Id.* § 1169(a)(3).

> (i) be in writing;
> (ii) provide for the notification of each person specified in a medical child support order as eligible to receive benefits under the plan . . . of such procedures promptly upon receipt by the plan of the medical child support order; and
> (iii) permit an alternate recipient to designate a representative for receipt of copies of notices that are sent to the alternate recipient.[312]

When a group health plan receives a medical child support order, the plan administrator must notify the participant of the order and explain the plan's procedures for determining whether it is qualified within a reasonable period after receipt of the order.[313]

Where a plan fiduciary acts in accordance with Part IV of ERISA by treating an order as a qualified medical child support order, the plan's obligation to the participant and each alternate recipient is discharged to the extent of any payment made pursuant to the act of the fiduciary.[314] The alternate recipient under a qualified medical child support order is considered a beneficiary under the plan for purposes of ERISA and is treated as a participant under the plan for purposes of the reporting and disclosure requirements of Part I of ERISA.[315] Payment for benefits made by a group health plan pursuant to a medical child support order and reimbursement for expenses paid by an alternate recipient, the recipient's custodial parent, or legal guardian are made to the recipient, the recipient's custodial parent, or legal guardian.[316]

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[311] *Id.* § 1169(a)(5)(B).

[312] *Id.* An "alternate recipient" is defined as any child of a participant who is recognized under a medical child support order as having a right to enrollment under a group health plan with respect to the participant. *Id.* § 1169(a)(2)(C).

[313] *Id.* § 1169(a)(5)(A)(i). The plan administrator must determine whether the order is a qualified medical child support order and notify the participant and alternate recipient of the determination. *Id.* § 1169(a)(5).

[314] ERISA § 609(a)(6), 29 U.S.C.A. § 1169(a)(6).

[315] 29 U.S.C.A. § 1169(a)(7).

B. Health Plan Coverage of Adopted Dependents

Any health plan providing coverage for dependent children of participants or beneficiaries must provide benefits to dependent children placed for adoption under the same terms and conditions as natural dependent children, regardless of whether the adoption has become final.[317] The plan may not restrict coverage of any adopted child solely on the basis of a child's pre-existing condition if placement for adoption occurs while the participant or beneficiary is eligible for coverage under the plan.[318] A "child" is defined to include individuals who have not obtained age eighteen as of the date of placement for adoption.[319] The Department of Labor has issued an advisory opinion which clarifies many issues regarding mandatory health plan coverage of children placed for adoption. For example, if a plan provided coverage for dependent children prior to August 10, 1993, then the plan must extend coverage as of that date to children placed for adoption before August 10, 1993, who have been denied coverage under the same terms and conditions that apply to natural children.[320] Another issue clarified by the advisory opinion is that a group health plan may not refuse to provide coverage for children who are adopted by or placed for adoption with retired participants and beneficiaries.[321]

C. Miscellaneous Standards Added by OBRA '93

OBRA '93 amended the Social Security Act and added ERISA § 609(d) to provide that a group health plan may not reduce its coverage of the cost of pediatric vaccines below the coverage provided as of May 1, 1993.[322] The COBRA excise tax of $100 per day per beneficiary is imposed if a group health plan reduces a beneficiary's coverage of the costs of pediatric vaccines below the coverage provided as of May 1, 1993.[323] Group health plans must now provide that payment will be made in accordance with any assignment of rights as required by a state Medicaid program and in accordance with any state law which provides that the state has acquired the rights to payment with respect to a participant.[324] Each group medical plan must now provide that enrollment or payment of benefits is irrelevant to whether the individual is covered by Medicaid.[325]

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[316] *Id.* § 1169(a)(8).
[317] *Id.* § 1169(c).
[318] *Id.* § 1169(c)(2).
[319] *Id.* § 1169(c)(3)(A).
[320] DOL Advisory Opinion 95-18A (1995).
[321] *Id.*

VIII. UNIFORMED SERVICES EMPLOYMENT AND REEMPLOYMENT RIGHTS ACT OF 1994

Under the Uniformed Services Employment and Reemployment Rights Act (USERRA) of 1994, employees covered by employer-sponsored health plans are allowed to continue coverage under the plan for a period of up to eighteen months after the employee's departure for military service.[326]

IX. HEALTH INSURANCE PORTABILITY AND ACCOUNTABILITY ACT OF 1996

A. Group Health Plan Access Under HIPAA

Coverage cannot be denied on the basis of health-related factors regarding employees or their dependents.[327] In determining eligibility, group health plans cannot consider health status, medical condition, claims experience, receipt of health care, medical history, genetic information, disability, or evidence of insurability.[328] Premiums or contributions cannot vary based on health status.[329] However, plans may establish discounts and rebates based on employees' adherence to health promotion and disease prevention programs.[330]

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[322] ERISA § 609(d), 29 U.S.C.A § 1169(d).

[323] I.R.C. § 4980B(f)(1).

[324] 29 U.S.C. § 1169(b).

[325] *Id.* § 1169(b)(2).

[326] 38 U.S.C.A. § 4317(a)(1)(A) (1994).

[327] I.R.C. § 9802(a)(1) (West Supp. 1997).

[328] I.R.C. § 9802(a)(1).

Special enrollment periods are required for employees or dependents who lose coverage under another health plan.[331] In order to be eligible for a special enrollment period, the individual must have been (1) covered under another plan when coverage was offered under the group health plan, (2) receiving coverage under a COBRA continuation period which is subsequently exhausted, or (3) have become ineligible for coverage under another plan due to legal separation, divorce, death, termination of employment or reduction in hours.[332] Additional requirements for eligibility include:

> (1) The individual stated in writing at the time of enrollment that another source of coverage was the reason for initially declining enrollment, *if* the employer required such a statement and notified the individual of the requirement;
> (2) The individual requested enrollment in the group health plan within thirty (30) days after loss of coverage; and
> (3) For dependents, the special enrollment period must last at least thirty (30) days from the date of marriage, birth or adoption. Coverage is retroactive for newborns or newly placed children to the date of the birth or adoption.[333]

B. Portability

HIPAA limits the ability of group health plans to deny coverage because of a pre-existing condition.[334] A plan may exclude coverage for pre-existing conditions on new enrollees if:

> (1) [the] exclusion relates to a condition (whether physical or

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[329] *Id.* § 9802(b). A plan that requires a disabled qualified beneficiary entitled to a disability extension under COBRA to pay 150% of the applicable premium does not for that reason fail to comply with this requirement. Prop. Treas. Reg. § 54.4980B-1, 63 Fed. Reg. 708, 709 (1998).

[330] I.R.C. § 9802(b)(2)(B).

[331] *Id.* § 9801(f).

[332] *Id.*

[333] *Id.*

[334] *Id.* § 9801(a).

> mental), regardless of the cause of the condition, for which medical advice, diagnosis, care, or treatment was recommended or received within the six-month period ending on the enrollment date;
> (2) [the] exclusion extends for a period of not more than twelve months (or eighteen months in the case of a late enrollee) after the enrollment date; and
> (3) the period of any such preexisting condition exclusion is reduced by the length of the aggregate of the periods of creditable coverage (if any) applicable to the participant or beneficiary as of the enrollment date.[335]

Preexisting condition limitations cannot be imposed on a newborn or a newly-adopted child enrolled within thirty days of the birth, adoption, or placement for adoption.[336] A pre-existing condition limitation cannot apply to participation eligibility on the basis of pregnancy.[337] There is an exception where there is a break in a new employee's prior coverage that lasted more than sixty-three days, excluding waiting and affiliation periods.[338]

Generally, HIPAA applies to plan years beginning after June 30, 1997 for purposes of creditable coverage.[339] However, the certificate requirements apply to events occurring on or after July 1, 1996.[340] For events occurring on or after July 1, 1996, but before October 1, 1996, a certificate is required only upon written request.[341]

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[335] I.R.C. § 9801(a). The enrollment date is the date the employee enrolls in the health plan or the first day of a waiting period, if earlier. *Id.* § 9801(b)(2). Late enrollment occurs when an employee enrolls in the group health plan at any time other than during the initial eligibility period or the thirty-day enrollment period after other health coverage ends. *Id.* § 9801(b)(3). "Creditable coverage" includes coverage under virtually any employer group health plan, health insurance coverage, Medicare, Medicaid, military-sponsored health care and public health plans. *Id.* § 9801(c)(1). Employers that sponsor group health plans must provide employees with certification of creditable coverage automatically upon the employee's termination of coverage, upon becoming eligible for or ceasing COBRA coverage and upon request within twenty-four months of any such event. *Id.* § 9801(e)(1)(A). The certification covers the health plan, any applicable COBRA continuation coverage, and any waiting period imposed on the employee. I.R.C. § 9801(e)(1)(B).

[336] *Id.* § 9801(d)(1)-(2).

[337] *Id.* § 9801(d)(3).

[338] *Id.* § 9801(c)(2)(A).

[339] Health Insurance Portability and Accountability Act (HIPAA) of 1996, § 401(c)(1), 110 Stat. 2073 (1996).

HIPAA includes a transition rule for complying with the automatic certificate requirements for the events occurring on or after October 1, 1996 and before June 1, 1997.[342] A model notice satisfies the automatic certificate requirements if provided by first class mail no later than June 1, 1997.[343] If an individual requests a certificate following receipt of the notice, a certificate must be provided at the earliest possible time while acting in a reasonable and prompt fashion.[344] For events occurring on or after June 1, 1997 (or October 1, 1996, if the model notice is not provided by June 1, 1997), certificates must automatically be provided upon the occurrence of each event.[345]

C. COBRA Amendments

An eighteen to twenty-nine month extension is available to qualified beneficiaries if such beneficiary becomes disabled within the first sixty days of continuation coverage.[346] The term "qualified beneficiary" is expanded to include any child born to, adopted by, or placed for adoption with a covered employee within the continuation coverage period.[347] This amendment allows a covered employee to include a newborn or adopted child under a continuation policy immediately. The '96 Act also clarifies that COBRA coverage for an employee's spouse and dependents is limited to thirty-six months from the employee's entitlement to Medicare.[348]

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[340] HIPAA § 401(c)(2)(A)(i).

[341] *Id.* § 401(C)(2)(B)(iii).

[342] *See* 29 C.F.R. § 2590.736 (1997); 45 C.F.R. § 146.125 (1997).

[343] *See* 45 C.F.R. § 146.124(e).

[344] 45 C.F.R. § 146.125(e)(3)(iv).

[345] 29 C.F.R. § 2590.736.

[346] Prop. Treas. Reg. § 54.4980B-1(a)(1), 63 Fed. Reg. at 711.

[347] Prop. Treas. Reg. § 54.4980B-1(b), 63 Fed. Reg. at 711. The maximum coverage period for such a child is measured from the qualifying event. Prop. Treas. Reg. § 54.4980B-1(b), 63 Fed. Reg. at 708.

D. Employer's Disclosure Requirement

Upon a reduction in covered services or benefits, group health plan sponsors must provide participants with a summary of changes within sixty days.[349] Alternatively, a plan sponsor may provide a description of covered services or benefits at regular ninety-day intervals.[350] HIPAA amended ERISA to require summary plan descriptions of group health plans to include information indicating whether a health insurance issuer is responsible for the financing or administration of the plan.[351] Interim regulations provide that the amendment is intended to ensure that summary plan descriptions clearly inform participants and beneficiaries about the role of insurance issuers concerning their group health plan, particularly in those cases where the plan is self-funded and an insurance issuer is serving as a contract administrator or claims payor rather than an insurer.[352]

HIPAA also amended ERISA to require summary plan descriptions of group health plans to include the office at the Department of Labor through which participants and beneficiaries may seek assistance or information regarding their rights under ERISA.[353] The model statement of ERISA rights is revised to replace the last sentence of that statement with an updated sentence that reads as follows:

> If you have any questions about this statement or about your

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[348] I.R.C. § 4980B(f)(2)(B)(V).

[349] ERISA § 104(a)(1)(D), 29 U.S.C. § 1024(a)(1)(D).

[350] 29 C.F.R. § 2520.104b-3(d)(2).

[351] *See* ERISA § 101(b), 29 U.S.C.A. § 1022(b).

[352] *See* 29 C.F.R. § 2520.102-3(q). The regulations require the summary plan description of any plan, where a health insurer is responsible, in whole or in part, for the financing or administration of a group health plan, to include the name and address of the insurer, whether and to what extent benefits under the plan are guaranteed under a contract or policy of insurance issued by the insurer, and the nature of any administrative service, such as payment of claims, provided by the issuer. *Id.*

[353] *See* ERISA § 101(b), 29 U.S.C.A. § 1022(b).

> rights under ERISA, you should contact the nearest office of the Pension and Welfare Benefits Administration, U.S. Department of Labor, listed in your telephone directory, or the Division of Technical Assistance and Inquiries, Pension and Welfare Benefits Administration, U.S. Department of Labor, 200 Constitution Avenue, N.W., Washington, D.C. 20210.[354]

Administrators may include in this statement the address and telephone number of the nearest office or offices of the Pension and Welfare Benefits Administration. A directory of the current Pension and Welfare Benefit Administration regional and district offices is printed in the interim regulations.[355]

X. MENTAL HEALTH PARITY ACT

The Mental Health Parity Act (Parity Act) amended ERISA to prohibit a group health plan that provides both medical and surgical benefits as well as mental health benefits from imposing aggregate lifetime limits or annual limits on mental health benefits unless the plan also imposes the limits on "substantially all" medical and surgical benefits.[356] The Parity Act provides that if a plan limits medical and surgical benefits, it must either provide the same lifetime limit both to medical and surgical benefits and to the mental health benefits and make no distinction between them, or not impose any lesser aggregate lifetime limit on mental health benefits.[357] Small employer plans which have fifty or less employees are exempt from such provision.[358] The Parity Act does not require a plan to provide mental health benefits or to change the terms and conditions regarding the amount, duration or scope of the benefits, except as required by the provisions concerning aggregate lifetime and annual limits.[359] Therefore, a plan may counteract the effect of these limits by increasing limits on outpatient limits and in-patient hospital days.

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[354] 29 C.F.R. § 2520.102-3(t)(2).

[355] *Id.*

[356] ERISA § 712, 26 U.S.C. § 9812(a) (1997). The effective date of this amendment is for health plan years beginning on or after January 1, 1998, and thereafter for services furnished through September 29, 2001. *Id.*

[357] *Id.*

[358] *Id.*

XI. NEWBORNS' AND MOTHERS' HEALTH PROTECTION ACT OF 1996

The Newborns' and Mothers' Health Protection Act of 1996 (Maternity Act) provides that no group health plan or health insurer offering hospitalization benefits in connection with childbirth may restrict the period of hospitalization after birth to less than forty-eight hours for a vaginal delivery or ninety-six hours for a cesarean delivery.[360] An exception applies if the attending health care provider, in consultation with the mother, decides that an earlier discharge is appropriate.[361]

The Maternity Act also provides an assortment of restrictions on health plans designed to prevent them from circumventing the requirement. These restrictions include prohibitions against (1) denying the mother or child the right to enroll in or renew coverage under a plan, solely to avoid compliance; (2) providing any monetary inducement to either mothers or health care providers to encourage acceptance of shorter hospital stays; or (3) penalizing or limiting the reimbursement of a health care provider for complying with its requirements.[362] Group health plans and insurers are not restricted from imposing deductibles, co-payments or other cost-sharing methods in connection with in-patient, postpartum care, but such plans and insurers may not increase the amounts participants are required to pay for any portion of the hospitalization period required by law.[363]

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[359] 29 C.F.R. § 2520.102-3(t)(2).

[360] 42 U.S.C.A. § 300gg-4(a)(1).

[361] *Id.* § 300gg-4(a)(2).

[362] *Id.* § 300gg-4(b).

[363] *Id.* § 300gg-4(c)(3). These changes are effective for group health plan years beginning on or after January 1, 1998. The Newborns' and Mothers' Health Protection Act of 1996, § 604(c), Pub. L. No. 104-204, 110 Stat. 2939.

XII. CONCLUSION

Because of the complexity of ERISA and the tremendous number of legislative and regulatory changes impacting group health plans, employers should immediately undertake a review of their plan documents and plan operations. Since the various effective dates of the required revisions are retroactive and prospective, employers should complete their analysis now in order to remedy violations and ensure subsequent compliance. The applicable excise taxes that have been enacted, as well as the new notice requirements, are strong motivations to initiate immediate review and revisions.

Although the changes are numerous and complex, the Internal Revenue Service has recently provided a great deal of guidance. Only with a careful review of the interaction of the various statutes and regulations can compliance be ensured.

COMMENTS

THE LONGSHORE AND HARBOR WORKERS' COMPENSATION ACT: AN ADMINISTRATIVE PRIMER WITH A CRITIQUE OF THE LAST-INJURIOUS-EXPOSURE RULE[*]

I. INTRODUCTION

Although subject to the formal adjudication requirements of the Administrative Procedure Act (APA),[1] the Longshore and Harbor Workers' Compensation Act (LHWCA)[2] and its attendant regulations[3] comprise a unique administrative scheme for adjudicating the claims of injured maritime employees. This article explores the procedural intricacies of filing and adjudicating a Longshore claim. As an example of the administrative difficulties that can arise under the LHWCA, this article will also consider the conflicting applications of the last-injurious-exposure rule.

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[*] Recipient of the 1997-98 Earl T. Thomas Award for Excellence in Writing presented by Alston, Rutherford, Tardy and Van Slyke Law Firm, Jackson, Mississippi. This award is presented annually to the author of the best comment submitted to the *Mississippi Law Journal.*

[1] Administrative Procedure Act, 5 U.S.C. §§ 551 (1994 & Supp. II 1996) *et. seq.* The APA's formal adjudication process is invoked in all adjudicatory situations in which the organic statute demands an adjudication "on the record" after the agency conducts a hearing. 5 U.S.C. § 554(a). *See* Portland Audubon Soc'y v. Endangered Species Comm., 984 F.2d 1534, 1540 (9th Cir. 1993) (holding APA's formal hearing requirements, delineated in sections 556-57, are triggered when three elements of section 554(a)—1) "an adjudication," 2) "determined on the record," 3) "after the opportunity for an agency hearing"—have been satisfied).

[2] 33 U.S.C. §§ 901-50 (1994). After enactment in 1927, the LHWCA endured many amendments, including major overhauls in 1972 and 1984. *See* Pub. L. No. 98-426, § 27(d)(1), 98 Stat. 1654 (1984) (detailing 1984 amendments); *see also* 1 Martin Norris, The Law of Maritime Personal Injuries § 4:1, at 108-09 (4th ed. 1990) (summarizing nine statutory changes implemented in 1984).

II. THE LHWCA'S GENERAL PURPOSE AND BASIC REQUIREMENTS

The LHWCA is federal workers' compensation for certain covered employees who are generally, but not always, ineligible for state workers' compensation.[4] Any compensation benefits received under the LHWCA represent a covered employee's exclusive remedy against his employer.[5] However, an injury or death caused by a third party allows the employee or his representative to collect LHWCA benefits from the employer and proceed against the third party in tort.[6] Given the LHWCA's remedial and humanitarian aim of providing compensation to injured employees,[7] it is liberally construed in a manner which avoids harsh results in order to foster its objective.[8] However, the employee retains the burden of persuasion and must satisfy it by a preponderance.[9]

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[3] 20 C.F.R. §§ 701.101-704.451 (1997).

[4] 32B AM. JUR. 2D *Federal Employers Liability and Compensation Acts* § 105 (1996) (citing Noruerica v. New York, N.H. & H.R. Co., 281 U.S. 128 (1930)). Because the LHWCA was patterned after New York's compensation statutes, it shares many similarities with state workers' compensation schemes. 1 THOMAS J. SCHOENBAUM, ADMIRALTY & MARITIME LAW § 7-1, at 371 (2d ed. 1994). For example, the LHWCA requires employers to provide medical benefits and indemnity to injured employees on a no fault basis. 33 U.S.C. § 904(b) (1994). The LHWCA, like other workers' compensation acts, is bottomed on the idea that industry is equipped better than the individual employee to handle the financial cost of on-the-job injuries. NORRIS, *supra* note 2, § 4-9 at 130.

[5] 33 U.S.C. § 905(a) (1994). If a covered employer refuses to pay the benefits required under the LHWCA, the employee can "claim compensation" or sue in admiralty or at law. *Id.* In such cases, the employer cannot assert the defenses of assumption of the risk or contributory negligence or the fellow servant doctrine. *Id.*

[6] 33 U.S.C. § 933 (1994). Vessels are included within the definition of third parties so an injured employee can proceed against a negligent vessel in rem. 33 U.S.C. § 905(b). In such a case, the employer has no obligation to indemnify a liable vessel. *Id.* Importantly, when an injured employee proceeds against a vessel, he must plead negligence, not breach of the warranty of seaworthiness. *Id.*

[7] 32B. AM. JUR. 2D *Federal Employers Liability and Compensation Acts* § 105

The LHWCA applies to a given injury or death upon the satisfaction of four requirements.[10] The first requirement is that the injury occur in the course of the worker's employment.[11] Second, the employer must qualify as a "maritime" employer.[12] Third, the injury or death must occur at a mari-

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(1996) (citing Chausse v. Lowe, 35 F. Supp. 1011, 1013 (E.D.N.Y. 1938)). *See* Pillsbury v. United Eng'g Co., 342 U.S. 197, 200 (1952) (recognizing humanitarian goals of LHWCA). The LHWCA is remedial in nature and balances the disparate interests of employers and injured employers. Potomac Elec. Power Co. v. Director, Office of Workers' Compensation Programs, 449 U.S. 268, 281-82 (1980).

[8] Voris v. Eikel, 346 U.S. 328, 333 (1953). *See also* Director, OWCP v. Perini, 459 U.S. 297, 315-16 (1983).

[9] Director, Office of Workers' Compensation Programs v. Greenwich Collieries, 512 U.S. 267, 278-81 (1994) (holding true doubt rule in conflict with section 556(d) of APA and thereby abolishing true doubt rule); *see also* Rachel Courtney, Casenote, Director, Officer of Workers' Compensation Programs v. Greenwich Collieries: *The Reasons for and Ramifications of Eliminating "True Doubt,"* 49 ADMIN. L. REV. 223, 224 (1997).

[10] Chesapeake & Ohio Ry. Co. v. Schwalb, 493 U.S. 40, 45 (1989). In this case, the United States Supreme Court held that the four elements were satisfied, thereby, making LHWCA benefits the exclusive remedy against the employer. *Schwalb*, 493 U.S. at 48. One commentator applauded the *Schwalb* opinion because it provided a fairly clear solution to the coverage problem of support workers who do not engage directly in shipbuilding or longshoring. SCHOENBAUM, *supra* note 4, § 7-2, at 379 n.30.

[11] *Schwalb*, 493 U.S. at 45. This element was undisputed in *Schwalb*. *Id.* This element is embedded in the LHWCA's definition of an injury which states, "[t]he term 'injury' means accidental injury or death arising out of and in the course of employment, and such occupational disease or infection as arises naturally out of such employment or as naturally or unavoidably results from such accidental injury, and includes an injury cause by the willful act of a third person directed against an employee because of his employment." 33 U.S.C. § 902(2) (1994). Many state compensation programs have this same "arising out of and in the course of employment" requirement. *See, e.g.*, MISS. CODE ANN. § 71-3-7 (1995).

[12] *Schwalb*, 493 U.S. at 45. It was undisputed that Chesapeake and Ohio Railway Company and Norfolk & Western Railway Company were maritime employers for LHWCA purposes. *Id.* at 45. A maritime employer is "an employer any of whose employees are employed in maritime employment, in whole or in part, upon the navigable waters of the United States (including any adjoining pier, wharf, dry dock, terminal, building way, marine railway, or other adjoining area customarily used by an employer in loading, unloading, repairing or building a vessel)." 33 U.S.C. § 902(4) (1994).

time situs.[13] Fourth, the injured employee must satisfy the employee status test.[14]

From the above test, it is clear that the LHWCA places the responsibility of paying compensation benefits on maritime employers only.[15] However, a maritime employer has the opportunity to defray the costs of compensation by buying insurance.[16] While the insurance option is available, the employer also may choose to self-insure.[17] Failure to buy proper insurance or self-insure appropriately will result in fines and/or imprisonment.[18] Further, maritime employers-general contractors are liable to provide compensation for a subcontractor's employees when the subcontractor fails to provide compensation.[19]

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[13] *Schwalb*, 493 U.S. at 45. It was undisputed that a railway terminal used to load coal from a railroad car to a vessel satisfied the situs test. *Id.* Compensation is payable, i.e., the situs test is passed, if the injury occurs "upon the navigable waters of the United States (including any adjoining pier, wharf, dry dock, terminal, building way, marine railway, or other adjoining area customarily used by an employer in loading, unloading, repairing, dismantling or building a vessel)." 33 U.S.C. § 903(a) (1994). Since enactment in 1927, the situs test, called the "situs riddle" by one commentator, has been subjected to intense judicial interpretation. John R. Hillsman, *Looking for a Lodestar Among the Rocks and Shoals of Longshore Coverage*, 3 U.S.F. MAR. L.J. 227, 230-38 (1991) (detailing judicial contours of locations specifically mentioned in 33 U.S.C. § 903(a)). Generally, the situs test geographically limits the application of the LHWCA by focusing on the spot of the injury. *Id.* at 231 (citing Alford v. MP Indus. 16 Ben. Rev. Bd. Serv. (MB) 261 (1984) (holding auto accident injuring employee while on errand for employer fails situs test)). Notably, 33 U.S.C. § 903(a)'s "other adjoining area" language seems to require a nexus between the spot of the injury and an "activity on navigable waters" for non-enumerated locations. SCHOENBAUM, *supra* note 4, § 7-2, at 376; *see also* Brady Hamilton Stevedore Co. v. Herron, 568 F.2d 137, 141 (9th Cir. 1978) (holding "other adjoining area" is not dependent upon physical contiguity but describes relationship between location and maritime activity).

[14] *Schwalb*, 493 U.S. at 45. The Supreme Court held that a pier machinist and a coal conveyor janitor satisfied the status test because repair and maintenance of coal conveyors are an "essential part of loading and unloading a vessel." *Id.* at 45-47. The status test is embedded in the LHWCA's definition of an employee which states, "[a]n 'employee' means any person engaged in maritime employment, including any longshoreman or other person engaged in longshoring operations, and any harbor-worker including a ship repairman, shipbuilder, and ship-breaker." 33 U.S.C. § 902(3) (1994). However, a master or crew member of any vessel or a person employed to repair, load or unload a small vessel are specifically excluded. 33 U.S.C. § 902(3)(G) & (H). Curiously, six other categories of employees are covered if not subject to state compensation programs, e.g., clerical workers, restaurant workers, some marina workers, aquaculture workers and workers building or repairing recreational vessels less than sixty-five feet. 33 U.S.C. § 902(3)(A)-(F). Because Congress did not intend to extend LHWCA benefits to "all those who breathe salt air," the employee status test functions as a gatekeeping device. Herb's Welding, Inc. v. Gray, 470 U.S. 414, 423 (1985) (holding welder on offshore drilling platform failed employee status test). *See* 1A BENEDICT ON ADMIRALTY, § 16e, at 2-52 to 2-101 (7th ed. revised 1997) (collecting cases on employee status test).

[15] However, it is far from clear which of several maritime employers should be assigned liability when successive employers expose a covered employee to an

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occupational disease. *See* discussion *infra* section VI (discussing last-injurious-exposure rule).

[16] 33 U.S.C. § 932(a)(1) (1994). The carrier chosen by the employer must be licensed to sell workers' compensation insurance and authorized by the Department of Labor (DOL) to underwrite LHWCA coverage specifically. 33 U.S.C. § 932(a)(1); 20 C.F.R. § 703.101 (1997).

When deciding whether to authorize a carrier's request to underwrite LHWCA coverage, the DOL can consider recommendations of state insurance departments. 33 U.S.C. § 932(b). In addition, the DOL may revoke for good cause any authorization to underwrite "after a hearing at which the carrier shall be entitled to be heard in person or by counsel and to present evidence." 33 U.S.C. § 932(b). For the employers buying insurance, the carrier steps into the shoes of the employer with regard to notice of injuries, jurisdiction and liability to pay compensation. 33 U.S.C. § 935 (1994). Any LHWCA insurance policy written by the carrier must state that the carrier remains liable to pay compensation even if the employer becomes bankrupt or insolvent during the policy period. 33 U.S.C. § 936(a) (1994). Additionally, a carrier must notify the Office of Workers' Compensation Programs (OWCP) thirty days prior to cancellation of a policy. 33 U.S.C. § 936(b); 20 C.F.R. § 703.114 (1997).

[17] 33 U.S.C. § 932(a)(2). A self-insuring employer must show proof of its ability to meet its financial obligations. *Id.* The self-insuring employer may need to post a bond or securities. *Id.*; 20 C.F.R. § 703.303 (1997).

[18] 33 U.S.C. § 938(a) (1994). The maximum fine is $10,000 and the maximum term of imprisonment is one year. 33 U.S.C. § 938(a). Notably, a corporate employer's president, secretary and treasurer are severally liable for the fines or imprisonment and severally personally liable along with the corporation for compensation owed to employees. *Id.*

[19] 33 U.S.C. § 904(a) (1994). In the event that a general contractor provides compensation "for the benefit of the subcontractor," a subcontractor has not failed to secure compensation. 33 U.S.C. § 904(a). This is known as a contract-under clause which is present in most state workers' compensation schemes. *See, e.g.*, MISS. CODE ANN. § 71-3-7 (1995). The Mississippi Supreme Court has even held general contractors liable to provide state workers' compensation benefits to the employees of a sub-subcontractor via its contract-under clause and thereby immune from tort liability when they do so. Crowe v. Brasfield & Gorrie Gen. Contractor, Inc., 688 So. 2d 752, 755-57 (Miss. 1996). *See generally* Kim Sands, Recent Decision, 67 MISS. L.J. 355 (1998). The current version of the LHWCA con-

III. BENEFITS AVAILABLE UNDER THE LHWCA

The LHWCA provides compensation[20] to an employee or his survivors for death, medical services or disability "arising out of and in the course of employment."[21] In the case of death, the LHWCA provides for compensation, known as a death benefit, payable to the employee's survivors.[22] However, the compensation shall not exceed sixty-six and two-thirds percent of the employee's average wages, exclusive of funeral expenses.[23] In the case of a work-related injury, an employee is eligible for both medical services and disability compensation.[24] Regarding medical services, the employer must provide to the employee, for the entire recovery period, medical

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tract-under clause, implemented in 1984, makes general contractors available to negligence suits as third parties when the subcontractor secures compensation for its own employees. Louviere v. Marathon Oil Co., 755 F.2d 428, 429-30 (5th Cir. 1985).

[20] Compensation is defined as "the money allowance payable to an employee or his dependents . . . and includes funeral benefits." 33 U.S.C. § 902(12) (1994).

[21] 33 U.S.C. § 902(2). Although the compensation scheme employed by the LHWCA is similar to state workers' compensation programs, glaring differences appear with regard to initial waiting periods, amounts of compensation, duration of certain disability payments and funeral expenses. *See, e.g.,* Christy Crockett, Comment, *The Longshore and Harbor Workers' Compensation Act: Impact on the Mississippi Gaming Industry*, 64 MISS. L.J. 680-84 (1995) (comparing LHWCA with Mississippi Workers' Compensation Act (MWCA)).

[22] 33 U.S.C. § 909 (1994). Survivors include a widow, children, other relatives dependent on the deceased employee and other dependents. 33 U.S.C. § 902(b)-(d). SCHOENBAUM, *supra* note 4, § 7-6, at 410-11.

[23] 33 U.S.C. § 902(b). The type and number of survivors will vary the percentage of wages paid. For example, a surviving widow without children receives fifty percent during widowhood "with two years' compensation in one lump sum upon remarriage." *Id.* However, a surviving unmarried widow with one surviving child receives fifty percent and the child sixteen and two-thirds percent. *Id.; see also* Crockett, *supra* note 21, at 683-84 (comparing MWCA with LHWCA concerning employee death).

In addition to the wage compensation, the LHWCA pays up to $3,000 in funeral expenses. 33 U.S.C. § 902(a). In contrast, the MWCA pays a maximum of $2,000, with $250 payable immediately, for funeral expenses. MISS. CODE ANN. § 71-3-25 (1995).

[24] 33 U.S.C. § 907-908 (1994). Medical services are exempt from 33 U.S.C. § 906(a)'s three day initial waiting period. 33 U.S.C. § 906(a) (1994). Medical services under the MWCA receive the same treatment. MISS. CODE ANN. § 71-3-11 (1995).

benefits and supplies such as medical, surgical and nursing care, medicines and crutches.[25] The employee, not the employer, chooses a doctor to render medical services from a list of DOL-approved doctors.[26] Additionally, the DOL, through the Office of Workers' Compensation Programs (OWCP), actively monitors the care received by an employee.[27] Although the employer or its insurance carrier bears the cost of providing medical services,[28] the OWCP regulates the fees charged by authorized doctors by limiting the fees to the rate which "prevail[s] in the community."[29]

Along with medical services, the employer must provide an injured employee with compensation for disability.[30] However, the LHWCA imposes a three day waiting period before compensation can begin.[31] The maximum rate of compensation is 200 percent of the national average weekly wage.[32] Further, in the case of total disability, the minimum rate of compensation is fifty percent of the national average weekly wage.[33] Furthermore, the LHWCA outlines three methods to calculate an employee's average weekly wage at the time of the injury, an important factor in compensation determination.[34]

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[25] 33 U.S.C. § 907(a); United States v. Bender Welding & Mach. Co., 558 F.2d 761, 763-64 (5th Cir. 1977) (holding LHWCA carrier liable for reimbursing VA hospital for medical services received by injured maritime employee). Other appropriate medical services include laboratory and x-ray services, prosthetic devices and "reasonable and necessary" travel expenses associated with the medical care. 20 C.F.R. § 702.401(a) (1997).

[26] 33 U.S.C. § 907(b). The Office of Workers' Compensation Programs (OWCP), a unit within the DOL, maintains a list of authorized doctors and debarred doctors. 20 C.F.R. § 702.403 (1997). In emergency situations, the employer can select a doctor on the employee's behalf, but the employee may change doctors thereafter. 33 U.S.C. § 907(b); 20 C.F.R. § 702.405 (1997). Contrastingly, the MWCA allows the employee to select any doctor without limitation by the Workers' Compensation Commission. MISS. CODE ANN. § 71-3-15(1) (1995).

[27] 33 U.S.C. § 907(b). The OWCP may require reports concerning the care received by the employee, determine the necessity of care and determine whether a change in physicians is appropriate. 20 C.F.R. § 702.407 (1997). If a medical question arises concerning appropriate treatment, the OWCP may require a special examination by an appointed doctor. 33 U.S.C. § 907(e); C.F.R. § 702.408 (1997). After the exam, the OWCP takes "action appropriate therewith." *Id.* Presumably, the employer can request the exam. SCHOENBAUM, *supra* note 4, § 7-6, at 406 n.6.

[28] 33 U.S.C. § 907(a); 20 C.F.R. § 702.402. Further, the employer's responsibility exists even if a third party's fault or negligence caused the injury. 33 U.S.C. § 907(h). However, the employer retains a subrogation right against a liable third party. *Id.*; 33 U.S.C. § 933(b) (1994); *see also* Fontana v. Pennsylvania R.R. Co., 106 F. Supp. 461, 462-64 (S.D.N.Y. 1952) (holding employer providing medical services should be reimbursed out of employee's recovery from third party).

[29] 33 U.S.C. § 907(g); 20 C.F.R. § 702.413 (1997). When a fee dispute arises, the OWCP determines the appropriate community fee by consulting the OWCP Medical Fee Schedule, published in 20 C.F.R. § 10.411, or other fee schedules. 20 C.F.R. § 702.413 (1997). *See* Newport News Shipbuilding & Dry Dock Co. v. Loxley, 934 F.2d 511, 516 (4th Cir. 1991) (upholding Administrative Law Judge's determination that doctor's "fees exceeded prevailing rate").

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[30] 33 U.S.C. § 908 (1994). According to the LHWCA, "disability" is defined as:

> incapacity because of injury to earn the wages which the employee was receiving at the time of injury in the same or any other employment; but such term shall mean permanent impairment, determined (to the extent covered thereby) under the guides to the evaluation of permanent impairment promulgated and modified from time to time by the American Medical Association, in the case of an individual whose claim is described in section 910(d)(2) [occupational diseases] of this title.

33 U.S.C. § 902(10) (1994). Disability is economic concept which is not the same as injury. SCHOENBAUM, *supra* note 4, § 7-6, at 407; *see also* Cordero v. Triple A Mach. Shop, 580 F.2d 1331, 1334 (9th Cir. 1978) (explaining disability as economic idea premised on "medical foundation"); Aerojet-General Shipyards, Inc. v. O'Keeffe, 413 F.2d 793, 795 (5th Cir. 1969) (explaining injury is not synonymous with disability); John W. McGrath Corp. v. Hughes, 289 F.2d 403, 405 (2d Cir. 1961) (holding that disability is economic term which should be evaluated based on employee's injury, age, experience, education and mental capabilities; "[a] person may be permanently totally disabled in an economic sense and still be ambulatory").

[31] 33 U.S.C. § 906(a) (1994). If the disability persists for more than fourteen days, the three day waiting period is waived. 33 U.S.C. § 906(a). In contrast, the MWCA imposes a five day waiting period. MISS. CODE ANN. § 71-3-11 (1995).

[32] 33 U.S.C. § 906(b)(1). The 200 percent maximum applies in cases of disability or death. *Id.* The LHWCA defines national average weekly wage as "the national average weekly earnings of production or nonsupervisory workers on private nonagricultural payrolls." 33 U.S.C. § 902(19). Each year the DOL determines the national average weekly wage. 33 U.S.C. § 906(b)(3).

[33] 33 U.S.C. § 906(b)(2). An exception to the fifty percent floor exists. The employee receives his average weekly wage, not fifty percent of the national average weekly wage, when his average weekly wage is less than fifty percent of the national average weekly wage. *Id.* In contrast, the MWCA sets the minimum compensation at twenty-five dollars per week. MISS. CODE ANN. § 71-3-13(1) (1995). While the minimum can be adjusted in "partial dependency cases and in partial disability cases," the Mississippi courts and legislature have yet to do so. Crockett, *supra* note 21, at 681 n.55 (quoting language from MISS. CODE ANN. § 71-3-13(1)).

[34] 33 U.S.C. § 910 (1994). First, the employee's average weekly wages are set

The LHWCA categorizes disabilities into four groups: permanent total, temporary total, permanent partial and temporary partial.[35] If a disability is classified as permanent total, the employee receives sixty-six and two-thirds percent of his average weekly wage for the duration of the disability.[36] If the disability is temporary total, the employee also receives sixty-six and two-thirds percent for the duration of the disability.[37] Unlike some state workers' compensation schemes,[38]

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equal to 1/52 of his average annual earnings. 33 U.S.C. § 910(d)(1). Second, to calculate an employee's average annual earnings, one must determine if an employee "worked in the employment in which he was working at the time of the injury, whether for the same or another employer, during substantially the whole of the year immediately preceding his injury." 33 U.S.C. § 910(a). If yes, the "average annual earnings shall consist of 300 times the average daily wage or salary for a six day worker and two hundred and sixty times the average daily wage or salary for a five day worker, which he shall have earned in such employment during the days when so employed." *Id.* If no, the average annual earnings of a six day employee is 300 times the average daily wage, or 260 times if a five day employee "which an employee of the same class working substantially the whole of such immediately preceding year in the same or in similar employment in the same or a neighboring place shall have earned in such employment during the days when so employed." 33 U.S.C. § 910(b). However, if it is impossible to fairly and reasonably apply the two methods above, the average annual earnings "shall be such sum as, having regard to the previous earnings of the injured employee in the employment in which he was working at the time of the injury, and of other employees of the same or most similar class working in the same or most similar employment in the same or neighboring locality, or other employment of such employee, including the reasonable value of the services of the employee if engaged in self-employment, shall reasonably represent the annual earnings capacity of the injured employee." 33 U.S.C. § 910(c). *See* Empire United Stevedores v. Gatlin, 936 F.2d 819, 8 (5th Cir. 1991) (explaining application of three calculation methods).

[35] 33 U.S.C. § 908 (1994).

[36] 33 U.S.C. § 908(a). Examples of permanent total disability include loss of both eyes, legs, feet, arms, hands or any combination thereof, unless conclusive contrary proof exists. *Id.* Other fact scenarios may also allow a disability to be classified as permanent total. *Id.*; Roger's Terminal & Shipping Corp. v. Director, Office of Worker's Compensation Programs, Dept. of Labor, 784 F.2d 687 (5th Cir. 1986) (holding back injury could render employee totally and permanently disabled in some situations); *see also* Fluor Corp. v. Cunnyngham, 403 F.2d 223, 224 (5th Cir. 1968) (defining permanent total disability as completely without wage earning power).

[37] 33 U.S.C. § 908(b).

[38] *See, e.g.*, MISS. CODE ANN. § 71-3-17 (1995) (limiting compensation for permanent or temporary disability to 450 weeks).

the LHWCA does not place a durational limit on the payment for permanent or temporary total disabilities; it is possible for a disabled employee to receive compensation for life under the LHWCA.[39]

Employees with permanent partial disabilities receive sixty-six and two-thirds percent in addition to temporary disability compensation according to a body part and duration schedule.[40] Permanent partial disability compensation for a scheduled injury requires no impairment of earnings capacity.[41] However, if an employee's disability is temporary partial and reduces earning capacity,

> the compensation shall be two-thirds of the difference between the injured employee's average weekly wages before the injury and his wage-earning capacity after the injury in the same or another employment, to be paid during the continuance of such disability, but shall not be paid for a period exceeding five years.[42]

IV. Agency Structure

The Secretary of the Department of Labor (DOL) is charged with administering the LHWCA.[43] The LHWCA expressly authorizes the DOL to make rules,[44] appoint medical advisers, employees, and deputy commissioners, and buy necessary materials.[45] Moreover, the LHWCA required the DOL to create compensation districts[46] and assign at least one deputy commissioner[47] to each district.[48]

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[39] Crockett, *supra* note 21, at 682 & n.61 (citing 33 U.S.C. § 908(a)-(b)).

[40] 33 U.S.C. § 908(c). For example, the schedule compensates for a lost arm by paying sixty-six and two-thirds percent of the average weekly wage for 312 weeks. 33 U.S.C. § 908(c)(1). The body part schedule also delineates compensation durations for a lost leg, hand, foot, eye, finger, etc. *See* 33 U.S.C. § 908(c)(1)-(23).

[41] Potomac Elec. Power Co. v. Director, Office of Workers' Compensation Programs, 449 U.S. 268, 269 (1980); SCHOENBAUM, *supra* note 4, § 7-6, at 409 & n.16. But compensation for a non-scheduled injury requires a reduction in earnings capacity. *Potomac*, 449 U.S. at 269-70.

[42] 33 U.S.C. § 908(e). Temporary partial disability compensation has been awarded for persistent numbness and lack of control over feet and legs. Air America, Inc. v. Director, Office of Workers' Compensation Programs, 597 F.2d 773 (1st Cir. 1979) (extending LHWCA coverage to Defense Base Act).

[43] 33 U.S.C. § 939(a) (1994). Although 33 U.S.C. § 939(a) mentions just "Secretary," the term is defined to mean the Secretary of Labor. 33 U.S.C. § 902(6) (1994). Generally, the DOL's purpose "is to foster, promote, and develop the welfare of the wage earners of the United States, to improve their working conditions, and to advance their opportunities for profitable employment." OFFICE OF THE FEDERAL REGISTER, NATIONAL ARCHIVES AND RECORDS ADMINISTRATION, THE UNITED STATES GOVERNMENT MANUAL 1997/1998 369 (Karen L. Ashlin ed., 1997)

Within the DOL, there is a program agency entitled the Employment Standards Administration (ESA)[49] which created a sub-unit, the Office of Workers' Compensation Programs (OWCP).[50] The DOL has delegated to the OWCP, by regulation, the authority to administer the LHWCA.[51] The Director of the OWCP has authority to define the compensation districts created in 33 U.S.C. § 939(b).[52] Currently, the OWCP operates

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[hereinafter GOVERNMENT MANUAL]. On March 4, 1913, the DOL became the ninth executive department. *Id.* (citing 29 U.S.C. § 551).

[44] 33 U.S.C. § 939(a). The DOL's rule-making authority does not allow for a change in the LHWCA's clear mandate. Insurance Co. of North America v. Gee, 702 F.2d 411, 414 (2d Cir. 1983) (citing Miller v. United States, 294 U.S. 435, 440 (1935)).

[45] 33 U.S.C. § 939(a). Necessary materials include law books, rent, personal services, printing services, and periodicals. *Id.*

[46] 33 U.S.C. § 939(b). The districts must include all areas in the United States and the high seas to which the LHWCA applies. *Id.*

[47] *Id.* While the regulations substitute "District Director" for "Deputy Commissioner," the substitution does not change any entity's authority or responsibilities. 20 C.F.R. § 702.105 (1997).

[48] 33 U.S.C. § 939(b). Additionally, the DOL provides coverage and compensation information to any covered person. *Id.*; 20 C.F.R. § 702.136(a) (1997). Further, the DOL may provide legal assistance without charge in certain adjudications. *Id.*; 20 C.F.R. § 702.136(b) (1997). *See* Department of Labor v. Robertson, 625 F.2d 873 (9th Cir. 1980) (holding 33 U.S.C. § 939(b)'s grant of authority to DOL to provide legal assistance must be liberally construed to allow assistance in needy cases and courts cannot create rights or avoid plain statutory meaning).

[49] 20 C.F.R. § 701.201 (1997). The ESA is headed by an Assistant Secretary and has a mission of "administering and directing employment standards programs dealing with minimum wage and overtime standards . . . [and] worker's compensation programs for Federal and certain private employers and employees," among other things. GOVERNMENT MANUAL, *supra* note 43, at 378.

[50] 20 C.F.R. § 701.201. The OWCP is headed by a Director designated by the Assistant Secretary of Labor. *Id.* The OWCP administers the LHWCA, the Federal Employees Compensation Act and the Black Lung Benefits Act. GOVERNMENT MANUAL, *supra* note 43, at 381.

[51] 20 C.F.R. § 701.202 (1997); 20 C.F.R. § 1.2 (1997).

[52] 20 C.F.R. § 702.102(a) (1997). The OWCP can change the boundaries of the districts at will. 20 C.F.R. § 702.102(a).

a Division of Longshore and Harbor Workers' Compensation comprised of ten regional offices; the ten regional offices contain a total of thirteen district offices.[53] Each district office is led by a district director who maintains official records and operates the office during reasonable business hours.[54]

V. ADMINISTRATIVE PROCEDURES FOR FILING AND ADJUDICATING A LHWCA CLAIM

A. *Notice of Injury to the Employer and the OWCP from Employee*

After injury or death to a covered employee, the LHWCA requires the claimant to provide notice of the injury or death to the OWCP[55] and the employer within thirty days of the injury or death or thirty days after the claimant becomes aware or should have been aware of the nexus between the employment and the injury or death.[56] Because of the unique nature of long latency occupational diseases, like asbestosis, the period for notice for occupational diseases extends to one year after the claimant becomes aware or should have been aware of the nexus between the disease, employment and death or disability.[57] Notice is given by the employee, the deceased employee's beneficiary or someone acting on their behalf.[58] The LHWCA requires written notice, signed by the claimant or his representative, containing the employee's name, address and a statement about the injury or death.[59] An authorized person gives notice to the OWCP by hand or mail delivery.[60] Notice to the employer occurs by delivering it by mail or hand to the designated notice receiver.[61] While the employer may designate a partner or officer or a legal process agent to receive LHWCA injury notices, the employer also must designate representatives "among first line supervisors, local plant management, and personnel office officials."[62] An employer must designate at least one notice receiver whose name or position, exact location and telephone number is published at every job site in a conspicuous place.[63] Although the LHWCA presumes sufficient

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[53] While the DOL's Internet site lists thirteen district offices, form LS-203 adds a fourteenth office in Washington, D.C. *See* Appendix A for the Internet listing of the regional and district offices.

[54] 33 U.S.C. § 740(d) (1994). The records and claim reports filed with the OWCP become OWCP property. 20 C.F.R. § 702.112 (1997). An interested party may, at the OWCP's discretion after reviewing 5 U.S.C. 552(b), examine records on file. 20 C.F.R. § 702.113 (1997). An interested party may copy any records he is allowed to examine. 20 C.F.R. § 702.114 (1997). Additionally, the OWCP may require the use of certain claim forms. 20 C.F.R. § 702.121 (1997).

[55] 33 U.S.C. § 912(a) (1994). Specifically, the notice goes to the OWCP district office in which the injury or death occurred. 33 U.S.C. § 912(a); 20 C.F.R. § 702.211(a) (1997). Curiously, the regulations contradict the LHWCA by making notice to the OWCP permissive. 20 C.F.R. § 702.211(c). The more liberal approach of the regulation led one commentator to say that the regulation "reflects the fact that in practice few notices are filed by employees with the deputy commissioner." SCHOENBAUM, *supra* note 4, § 7-5, at 396 n.5.

[56] 33 U.S.C. § 912(a); 20 C.F.R. § 702.212(a) (1997); Jones Stevedoring Co. v. Director, Office of Workers Compensation Programs, 133 F.3d 683, 687 (9th Cir. 1997) ("clock starts running when reasonable diligence would have disclosed relationship between his injury and his employment"). With a loss of hearing, the date of injury is the date on which the employee receives an audiogram indicating loss of hearing associated with his employment. 20 C.F.R. § 702.212(a)(3). The United States Supreme Court classified hearing loss as an injury, not an occupational disease. Bath Iron Works v. Director, Office of Workers' Compensation Programs, 506 U.S. 153, 163 (1993). Thus the thirty-day notice period applies.

Jones Stevedoring, 133 F.3d at 687. The central goal of the thirty day notice requirement is to provide the employer a chance to conduct a timely investigation. Smith v. Aerojet-General Shipyards, Inc., 647 F.2d 518, 524 (5th Cir. 1981).

[57] 33 U.S.C. § 912(a); 20 C.F.R. § 702.212(b). The period for notice begins to run when the employee becomes disabled. *Id.* If retired, the notice period runs from the date of permanent impairment. *Id.*

[58] 33 U.S.C. § 912(b); 20 C.F.R. § 702.213 (1997).

[59] 33 U.S.C. § 912(b). The Office of Workers' Compensation Programs requires notice to be given on a specific form, currently LS-201. 20 C.F.R. § 702.214 (1997). The notice must be specific and detailed, not just a brief statement that an injury occurred, so the employer can investigate properly. Strachan Shipping Co. v. Davis, 571 F.2d 968, 972 (5th Cir. 1978).

[60] 33 U.S.C.A. § 912(c) (1986 & Supp. 1998); 20 C.F.R. § 702.215 (1997). The regulations, but not the statute, also allow a claimant to give notice to the OWCP verbally in person or over the telephone. 20 C.F.R. § 702.215.

[61] 33 U.S.C.A. § 912(c); 20 C.F.R. § 702.215.

[62] 33 U.S.C.A. § 912(c). First line supervisors include foremen, hatch bosses and timekeepers. 20 C.F.R. § 702.211(a) (1997). Failure to designate a notice receiver makes any person listed in the statute or regulations eligible to receive notice, and the failure to designate and publish the name and/or position of the receiver excuses any failure on the claimant's part to provide notice. 20 C.F.R. § 702.211(a), (b)(4).

[63] 20 C.F.R. § 702.211(b). The notice receiver must work full-time at the cov-

notice,[64] a claimant's failure to provide notice of the injury bars the claim unless: (1) the employer or insurer has knowledge of the injury or death,[65] (2) the OWCP believes no prejudice occurred, (3) the OWCP excuses the failure or (4) no objection to the failure is raised at the first hearing.[66]

B. Notice of Injury to the OWCP from the Employer

The employer has ten days after an injury or death or ten days after obtaining knowledge of the injury or death to supply the OWCP with a report detailing information on the injury or death.[67] An employer only need file a report if the injury causes the employee to miss at least one shift.[68] However, the employer must keep a record of the injury, even if it does not result in the missing of one shift.[69] An employer's report

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ered site, and there must be one receiver at every site. 20 C.F.R. § 702.211(b)(1). The employer should forward the receiver's name or title, location and telephone to the OWCP. 20 C.F.R. § 702.211(b)(2).

[64] 33 U.S.C. § 920(b) (1994).

[65] 33 U.S.C. § 912(d)(1). While the statute uses "knowledge" the regulations speak of "actual knowledge" and go on to say actual knowledge exists "if the employee's immediate supervisor was aware of the injury and/or in the case of a hearing loss, where the employer has furnished to the employee an audiogram and report which indicates a loss of hearing." 20 C.F.R. § 702.216 (1997). The knowledge requirement is satisfied when the employer knows of the injury, possesses facts which a reasonable man might use to conclude that a potential claim existed and that further investigation is needed. Stevenson v. Linens of the Week, 688 F.2d 93, 100 (D.C. Cir. 1982). *See* United Brands Co. v. Melson, 594 F.2d 1068, 1072-73 (5th Cir. 1979), *superseded by statute on other grounds as recognized by* Strachan Shipping Co. v. Nash, 751 F.2d 1460, 1467 n.13 (5th Cir. 1985) (holding employer knowledge sufficient when foreman saw employee in distress on-the-job and asked about his health and employee later had heart attack).

[66] 33 U.S.C. § 912(d). Given the breadth of these exceptions, claims are barred rarely for lack of timely notice. SCHOENBAUM, *supra* note 4, § 7-5, at 396.

[67] 33 U.S.C. § 930(a) (1994); 20 C.F.R. § 702.201 (1997). The statute suggests the report should be sent to the DOL and the OWCP, but the regulations only mention the OWCP. 33 U.S.C. § 930(a); 20 C.F.R. § 702.201. The regulations require the employer to deliver the original report and a copy to the OWCP. 20 C.F.R. § 702.203 (1997).

[68] 33 U.S.C. § 930(a); 20 C.F.R. § 702.201(b).

[69] 33 U.S.C. § 930(a); 20 C.F.R. § 702.201(b).

should be in writing on an OWCP form[70] and can be mailed.[71] Failure to file the report results in a fine[72] and a tolling of the one-year statute of limitations.[73]

C. Filing a LHWCA Claim

A claimant has one year from the date of injury or death to file a LHWCA claim with the OWCP.[74] However, this statute of limitations is extended to two years for an occupational disease.[75] With an injury or death, the statute begins to run when the claimant becomes aware or should have been aware of the nexus between the employment and the injury or death.[76] Similarly the occupational disease statute begins to

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[70] 20 C.F.R. § 702.202 (1997). Employers should use form LS-202.

[71] 33 U.S.C. § 930(d); 20 C.F.R. § 702.203.

[72] 33 U.S.C. § 930(e); 20 C.F.R. § 702.204 (1997). The failure must be knowing and willful and can result in a fine up to $10,000 for each "failure, refusal, false statement, or misrepresentation." 33 U.S.C. § 930(e); 20 C.F.R. § 702.204.

[73] 33 U.S.C. § 930(f); 20 C.F.R. § 702.205 (1997).

[74] 33 U.S.C. § 913(a) (1994); 20 C.F.R. § 702.221(a) (1997). If compensation is paid without a formal award and then terminated, a claim must be filed within one year of the last payment. 33 U.S.C. § 913(a); 20 C.F.R. § 702.221(a). *See generally* Ingalls Shipbuilding, Inc. v. Director, Office of Workers' Compensation Programs, 117 S. Ct. 796, 804-05 (1997) (reviewing LHWCA claim and appeal process).

[75] 33 U.S.C. § 913(b)(2); 20 C.F.R. § 702.222(c) (1997).

[76] 33 U.S.C. § 913(a). For hearing loss claims, the statute begins to run when the employee receives an audiogram indicating employment-related hearing loss. 20 C.F.R. § 702.221(b).

In the case of a welder with a latent back injury, the Sixth Circuit held that the "statute of limitations begins to run only after the employee becomes aware of the full character, extent, and impact of the injury." Paducah Marine Ways v. Thompson, 82 F.3d 130, 132 (6th Cir. 1996). *Accord* Duluth, Missabe & Iron Range Railway Co. v. Director, Office of Workers' Compensation Programs, 43 F.3d 1206, 1208 (8th Cir. 1994) (adopting awareness theory and stating appellate courts have uniformly adopted awareness theory); Newport News Shipbuilding & Dry Dock Co. v. Parker, 935 F.2d 20, 27 (4th Cir. 1991) (holding statute of limitations does not start until employee "knew or had reason to know" his injury would probably impair earning capacity); Abel v. Director, Office of Workers' Compensation Programs, 932 F.2d 819, 822 (9th Cir. 1991) (re-affirming awareness theory even when no doctor misdiagnosis occurred); Brown v. Jacksonville Shipyards, Inc., 893 F.2d 294, 296 (11th Cir. 1990) (endorsing awareness theory and stating "claimant must know that there was an injury which constituted an impairment of earning power. The fact that the claimant has suffered an accident run when the claimant becomes aware or should have been aware of the nexus between the disease, the employment and the death or disability.[77] Additionally, the claim statute of limitation is tolled until the termination of any unsuccessful lawsuits by the employee against the employer.[78] In order for the statute of limitations to bar a claim, an objection must be raised at the first hearing.[79] The claim must be in writing, and the OWCP has designated a specific claim form.[80]

D. OWCP Notice to Employers

Upon receiving a claim, the OWCP has ten days to notify the employer and any other interested parties.[81] Other interested parties include the employer's insurance carrier, and the notice must be in writing and served via registered mail or in person.[82]

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and is aware that he is injured is not the test; the test is the awareness of the suffering of a compensable injury"); Marathon Oil Co. v. Lunsford, 733 F.2d 1139, 1141 (5th Cir. 1984) (stating "[f]or prescription to run against him [the employee], he must know (or should know) the true nature of his condition, i.e., that it interferes with his employment by impairing his capacity to work, and its causal connection with his employment").

[77] 33 U.S.C. § 913(b)(2); 20 C.F.R. § 702.222(c). The regulations go on to say that the date of disablement is key. 20 C.F.R. § 702.222(c).

[78] 33 U.S.C. § 913(d); 20 C.F.R. § 702.222(b). The filing of a state workers' compensation claim also tolls the statute of limitations. 20 C.F.R. § 702.222(b); Ingalls Shipbuilding Div., Litton Systems, Inc. v. Hollinhead, 571 F.2d 272 (5th Cir. 1978) (holding that filing MWCA claim tolled LHWCA claim statute of limitations).

[79] 33 U.S.C. § 913(b)(1); 20 C.F.R. § 702.223 (1997).

[80] 20 C.F.R. § 702.221(a). Claims are filed on form LS-203. Claimants must wait at least seven days after the disability before filing in the case of an injury but may file immediately after a death. 33 U.S.C. § 919(a) (1994); 20 C.F.R. § 702.221(a).

[81] 33 U.S.C. § 919(b); 20 C.F.R. § 702.224 (1997). *See* Ingalls Shipbuilding, Inc. v. Director, Office of Workers' Compensation Programs, 117 S. Ct. 796, 804 (1997).

[82] 33 U.S.C. § 919(b); 20 C.F.R. § 702.224. *See* United States Cas. Co. v. Taylor, 64 F.2d 521, 525 (4th Cir. 1933) (holding insurance carrier of employer is interested party).

E. Employer Response to Claim Notice

After the employer receives notice of a claim, the employer has three options: (1) begin making the compensation payments spelled out in the LHWCA, (2) agree to a formal settlement with the claimant or (3) deny liability, i.e., controvert the claim.[83]

1. Noncontroverted Claims

If the employer or carrier does not controvert the claim, compensation payments should begin fourteen days after obtaining knowledge or notice of the employee's death or injury.[84] These are known as payments without an award. The employer must notify the OWCP after the first payment[85] and is required to make prompt semi-monthly payments directly to the claimant thereafter.[86] Failure to make a payment within fourteen days of the due date subjects the employer to a ten percent penalty, which can be excused by the OWCP in some situations.[87]

2. Formal Settlement of Claims

The employer and the employee are free to settle the claim, presumably for an amount less than mandated under the LHWCA,[88] at any time.[89] The settlement, however, is subject to approval of the OWCP or an Administrative Law Judge (ALJ).[90] If the OWCP disapproves of the settlement, the OWCP issues, within thirty days, a written report explaining the reasons.[91] An approved settlement discharges the employer's liability.[92] Notably, the settlement option seems unavailable to non-employee claimants.[93]

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[83] *Ingalls*, 117 S. Ct. at 804.

[84] 33 U.S.C. § 914(b) (1994); 20 C.F.R. § 702.232 (1997).

[85] 33 U.S.C. § 914(c); C.F.R. § 702.234 (1997). The employer should use form LS-206 to notify the OWCP.

[86] 33 U.S.C. § 914(b); C.F.R. § 702.232.

[87] 33 U.S.C. § 914(e); C.F.R. § 702.233 (1997).

[88] *Ingalls*, 117 S. Ct. at 804.

[89] 33 U.S.C. §§ 908(i)(1), (i)(3) (1994); C.F.R. §§ 702.241-702.243 (1997).

[90] 33 U.S.C. § 908(i)(1); C.F.R. §§ 702.241-702.243.

[91] 33 U.S.C. § 908(i)(2); 20 C.F.R. § 702.243(c). An OWCP disapproval is appealable to an ALJ. 33 U.S.C. § 908(i)(2); 20 C.F.R. § 702.243(c).

3. *Controverted Claims*

The employer may also controvert the claim, i.e., deny liability.[94] If the employer so chooses, the LHWCA requires a filing of notice with the OWCP within fourteen days after acquiring knowledge of the injury or death.[95] The employer should give notice on form LS-207, and the notice must include the reason for controversion.[96]

F. Adjudicating Claims

1. *Phase One—OWCP Informal Conference*

Upon receipt of a controverted claim, the OWCP begins the adjudicative process.[97] The first phase is an informal conference conducted by the OWCP.[98] According to the regulations, a large percent of the conflicts between employers and claimants result from "misunderstandings, clerical or mechanical errors, or mistakes of fact or law"; therefore, these type of disputes do not require formal hearings and are better resolved informally.[99] The goal of the OWCP in an informal conference is to safeguard the rights of all parties while resolving conflicts as soon as possible.[100] The informal conference must be preceded by ten days' notice, and the notice, provided by the OWCP, must include the date, time and location of the conference as well as the topics for discussion.[101] Although conferences usually are held at the OWCP, the conference can be in a more convenient place.[102] During the conference, the regulations prohibit witnesses and stenographic reports, but they emphasize the OWCP's role in guiding the discussions toward mutually agreeable solutions.[103] While no conference report is produced, the OWCP is charged with maintaining an administrative file throughout the informal phase; the file should include records of telephone conversations with parties, copies of correspondence, conference notices and short summaries of the informal conferences.[104] Although the OWCP no longer has the power to conduct a formal hearing,[105] the OWCP retains the authority to conduct necessary investigations regarding a claim during the informal phase,[106] as well as the power to mandate a physical exam from the injured employee[107] and the power to order a formal hearing upon the request of an interested party.[108] If, during an informal conference, the parties reach an agreement, the OWCP composes a memorandum[109] or issues a final compensation order within thirty days.[110] When the parties can not reach an agreement at the informal conference, the OWCP representative shall end the conference, consider all evidence and compose a memo detailing outstanding issues, material facts and recommendations for resolution.[111] The OWCP sends the memo to the parties and asks them to respond in writing within fourteen days as to whether they agree or disagree with the recommendations.[112] If the parties disagree,[113] the OWCP may: (1) schedule additional informal conferences if potentially fruitful[114] or (2) transfer the claim to the Office of the Chief ALJ for a formal hearing.[115]

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[92] 33 U.S.C. § 908(i)(3); 20 C.F.R. § 702.243(b).

[93] S.H. DuPuy v. Director, Office of Workers' Compensation Programs, 519 F.2d 536, 540 (7th Cir. 1975). Congress intended settlement for injured employees, not other claimants. *S.H. DuPuy*, 519 F.2d at 540. *See* 32B AM. JUR. 2D *Federal Employers' Liability and Compensation Acts* § 128 (1996).

[94] *Ingalls*, 117 S. Ct. at 804.

[95] 33 U.S.C. § 914(d) (1994); 20 C.F.R. § 702.251 (1997). The employer needs to send a copy to the claimant also. 33 U.S.C. § 914(d); 20 C.F.R. § 702.251.

[96] 33 U.S.C. § 914(d); 20 C.F.R. § 702.251. Often the receipt of form LS-207 first alerts the OWCP of a dispute. 1A BENEDICT, *supra* note 14, § 77c, at 4-224.

[97] 20 C.F.R. § 702.252 (1997).

[98] 20 C.F.R. § 702.301 (1997); *Ingalls*, 117 S. Ct. at 804. While the informal conference is the usual starting point, the LHWCA and the case law suggest this phase can be by-passed at the request of a party. *See* 33 U.S.C. § 919(c) (1997) (stating OWCP "upon application of an interested party shall order a [formal ALJ] hearing"); Ingalls Shipbuilding, Inc. v. Asbestos Health Claimants, 17 F.3d 130, 133-35 (5th Cir. 1994) (holding OWCP has clear, ministerial, non-discretionary duty to transfer claims to Office of Administrative Law Judges for formal hearing even if faced with administrative concerns).

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[99] 20 C.F.R. § 702.301. Triumphantly, the DOL proclaimed that in 1996, 3,000 OWCP informal conferences were conducted at an approximate cost of $300 each, as opposed to $2,000 for each ALJ formal hearing. Employment Standards Administration, Longshore and Harbor Workers' Compensation Program (visited Feb. 23, 1998) <http://gatekeeper.dol.gov/dol/esa/public/regs/compliance/owcp/lsfact.htm>.

[100] 20 C.F.R. § 702.311 (1997).

[101] 20 C.F.R. § 702.313 (1997).

[102] 20 C.F.R. § 702.314(b) (1997).

[103] 20 C.F.R. § 702.314(a). The OWCP representative at the conference shall be the district director or his designee, a claims examiner. *Id.*; 20 C.F.R. § 702.312 (1997). The regulations suggest that the OWCP representative should give the "parties the benefit of his experience and specialized knowledge in the field of workmen's compensation." 20 C.F.R. § 702.314(a).

[104] 20 C.F.R. §§ 702.311-702.315 (1997).

[105] 33 U.S.C. § 919(d) (1994). Prior to 1972, the OWCP had administrative and adjudicatory duties; however, today the OWCP handles only administrative duties. Ingalls Shipbuilding, Inc. v. Asbestos Health Claimants, 17 F.3d 130, 132-33 (5th Cir. 1994).

[106] 33 U.S.C. §§ 914(h), 919(c).

[107] 33 U.S.C. §§ 914(h), 919(h).

The OWCP prepares the claim for transfer by collecting from each party a pre-hearing statement and all evidence each party wants to submit.[116] The OWCP can not transfer its recommendations, memos or the administrative file.[117] Once the transferable information is collected, the OWCP sends it to the Office of the Chief ALJ with a letter of transmittal.[118]

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[108] 33 U.S.C. §§ 914(h), 919(c).

[109] 20 C.F.R. § 702.315(a). The memorandum is due ten days after the final conference. *Id.*

[110] *Id.* The regulations require the employer to begin payment at the time of the agreement without waiting for the memo or final order. *Id.*

[111] 20 C.F.R. § 702.316 (1997). One commentator mentions that all aspects of the claim should be mentioned in the OWCP recommendation. ALBERT J. MILLUS & JOSEPH F. MANES, THE LONGSHOREMEN'S AND HARBOR WORKERS' COMPENSATION ACT AND ITS EXTENSIONS 173 (1978).

[112] 20 C.F.R. § 702.316. This extra fourteen days may encourage "intransigence on the part of the employer-carrier." MILLUS & MANES, *supra* note 111, at 173.

[113] In the event that both parties agree to the OWCP recommendation, the claim proceeds as if an agreement had been reached at the informal conference. 20 C.F.R. § 702.316 (citing 20 C.F.R. § 702.315(a)).

[114] Notably, even if the OWCP schedules additional conferences, a party can demand a formal hearing thereby forcing a transfer to an ALJ. *Id. See* MILLUS & MANES, *supra* note 111, at 173; Ingalls Shipbuilding, Inc. v. Asbestos Health Claimants, 17 F.3d 130, 133-35 (5th Cir. 1994). All parties must be given at least ten days' notice of the formal hearing, served personally, by registered mail or by certified mail. 33 U.S.C. § 919(c).

[115] 20 C.F.R. § 702.316; Ingalls Shipbuilding, Inc. v. Director, Office of Workers' Compensation Programs, 117 S. Ct. 796, 804 (1997).

[116] 20 C.F.R. § 702.317 (1997).

[117] 20 C.F.R. §§ 702.317-702.318 (1997). If a party believes the administrative file contains helpful information, he can obtain it from the OWCP and re-intro-

2. *Phase Two—ALJ Formal Hearings*

Formal hearings under the LHWCA are initiated at the request of an interested party[119] or upon the completion of unsuccessful informal conferences.[120] The LHWCA requires these formal adjudications to conform to section 554 of the APA, and an ALJ conducts the hearings.[121] As of 1972,[122] the ALJ has the power to resolve all disputed claim issues,[123] maintain order during the formal hearing, issue subpoenas, administer oaths, force witness attendance and testimony, compel production of documents, take depositions, examine witnesses and "do all things conformable to law which may be necessary to enable him effiectively [sic] to discharge the duties of his office."[124] In addition, the ALJ is not bound by rules of evidence or procedure or the common law.[125]

Notice of the formal hearing is sent at least thirty days prior to the hearing and must include the place and time.[126] The parties may choose any representative they wish.[127] Before the formal hearing, the parties may submit a brief to the ALJ and serve it upon the other party.[128] Also the parties

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duce it in the formal hearing. 20 C.F.R. § 702.319 (1997). Although claim forms, controversion forms and the like can be obtained, the work product of the OWCP is off limits. 20 C.F.R. § 702.319.

[118] 20 C.F.R. § 702.317(c); 20 C.F.R. § 702.331 (1997).

[119] 33 U.S.C. § 919(c).

[120] 20 C.F.R. § 702.316; *Ingalls*, 117 S. Ct. at 804.

[121] 33 U.S.C. § 919(d); 20 C.F.R. § 702.332 (1997); *Ingalls*, 117 S. Ct. at 804.

[122] 33 U.S.C. § 919(d) (transferring all formal hearing powers mentioned in LHWCA from OWCP to ALJ).

[123] 33 U.S.C. § 919(c).

[124] 20 C.F.R. § 927(a) (1994). *See* 20 C.F.R. §§ 702.338-702.351 (1997).

[125] 33 U.S.C. § 923(a); 20 C.F.R. § 702.339 (1997). The ALJ is bound by the APA and the regulations. 33 U.S.C. § 923(a); 20 C.F.R. § 702.339.

[126] 20 C.F.R. § 702.335 (1997). The regulation's thirty day notice requirement modifies the statute's requirement of *at least* ten days' notice. 33 U.S.C. § 919(c) (emphasis added).

[127] 20 C.F.R. § 702.334 (1997).

[128] 20 C.F.R. § 702.343 (1997).

have an opportunity for pre-hearing discovery via depositions and interrogatories.[129]

During the formal hearing, the proceeding will be stenographically recorded and later transcribed.[130] In addition, each party may make oral arguments,[131] present witnesses[132] and submit documentary evidence.[133] After the presenting of all evidence, the ALJ terminates the hearing[134] and makes a final decision based on the testimonial transcript and the incorporated documents.[135] The ALJ has twenty days after the formal hearing to render a final decision and order; the ALJ must reject the claim or make an award.[136] The ALJ then files the order and transcript with the OWCP, which mails a copy of the order to the parties.[137] However, the order is effective upon filing with the OWCP.[138] Parties have thirty days to appeal the decision to the Benefits Review Board (BRB), otherwise the order is final.[139]

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[129] 20 C.F.R. § 702.341 (1997). Depositions and interrogatories are conducted according to the Federal Rules of Civil Procedure and the appropriate local rules. 20 C.F.R. § 702.341; *see also* SCHOENBAUM, *supra* note 4, § 7-5, at 398 n.26 (citing 29 C.F.R. §§ 18.13-18.23 for discovery regulations and citing 29 C.F.R. § 18.40 for summary deposition procedures).

[130] 20 C.F.R. § 702.344 (1997); 20 C.F.R. § 702.332 (1997). All formal hearings are public. 20 C.F.R. § 702.344.

[131] 20 C.F.R. § 702.343.

[132] 20 C.F.R. § 702.340 (1997).

[133] 20 C.F.R. § 702.344.

[134] 20 C.F.R. § 702.347 (1997).

[135] 20 C.F.R. § 702.344. One commentator suggests that LHWCA practitioners always must be aware of the record because of the possibility of later appeals and because the OWCP recommendations are not transferred to the ALJ. MILLUS & MANUS, *supra* note 111, at 179 (citing Pittston v. Dellaventura, 544 F.2d 35, 52-54 (2d Cir. 1976) (admonishing parties for making inadequate record by leaving twelve important questions unanswered)). The practitioner should develop every disputed fact during the formal hearing. *Id.* Also, the presentation of medical testimony is preferred to submitting medical reports because the ALJ may not fully understand the injury and its effects. *Id.*

[136] 33 U.S.C. § 919(c); 20 C.F.R. § 702.348 (1997). The order includes the ALJ's factual findings and legal conclusions. 20 C.F.R. § 702.348.

[137] 33 U.S.C. § 919(e); 20 C.F.R. § 702.349 (1997).

[138] 20 C.F.R. § 702.350 (1997).

[139] 33 U.S.C. § 921(a) (1994); 20 C.F.R. § 702.350; 20 C.F.R. § 702.393 (1997).

3. Phase Three—Appellate Review by Benefits Review Board

If a party appeals an ALJ order, the LHWCA authorizes the BRB, a quasi-judicial body, to hear and decide cases "raising a substantial question of law or fact."[140] The BRB is comprised of five permanent DOL appointees with one serving as chairman.[141] In addition, the chairman may request the designation of four temporary associate members culled from the ALJ ranks.[142] The permanent members serve indefinite terms while the associate members serve for a maximum of one year.[143] A BRB quorum consists of three permanent members, and an affirmative vote of three permanent members is required for official action when the BRB sits en banc.[144] However, the BRB also may sit in three member panels.[145] With a panel, a quorum consists of two members, and an affirmative vote of two members is required for official action.[146] If a party is dissatisfied with a BRB panel's decision, a petition for en banc review may be granted upon the favorable vote of a majority of permanent members.[147]

The ALJ hearing record is the basis for a BRB order.[148] Importantly, the BRB must apply the "substantial evidence" standard of review. The BRB may reverse an ALJ order only if the factual findings and legal conclusions are not "supported by substantial evidence" present in the ALJ hearing record.[149]

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[140] 33 U.S.C. § 921(b)(3); 20 C.F.R. §§ 702.391-702.392 (1997); 20 C.F.R. §§ 801.102-801.103 (1997). *See generally* Ryan-Walsh Stevedoring v. Trainer, 601 F.2d 1306 (5th Cir. 1979) (stating BRB functions quasi-judicially but may not participate in administration via rule-making).

[141] 33 U.S.C. § 921(b)(1); 20 C.F.R. § 801.201(a)-(b) (1997).

[142] 33 U.S.C. § 921(b)(5); 20 C.F.R. § 801.201(c)-(d). *See* NORRIS, *supra* note 2, § 4:53, at 231 (stating BRB has total of nine members now).

[143] 20 C.F.R. § 801.201(a), (d). A permanent member serves at the pleasure of the Secretary of Labor. 20 C.F.R. § 801.201(a).

[144] 33 U.S.C. § 921(b)(2); 20 C.F.R. § 801.301(a) (1997). Usually, BRB sessions are held at 200 Constitution Avenue, N.W., Room N-5101, Washington, DC 20210. 20 C.F.R. § 801.303 (1997). The BRB maintains a public docket and publishes its opinions. 20 C.F.R. § 802.302 (1997). LHWCA cases are collected in the Benefit Review Board Service's *Longshore Reporter*, a Matthew Bender publication.

[145] 33 U.S.C. § 921(b)(5); 20 C.F.R. 802.407(b).

[146] 33 U.S.C. § 921(b)(5); 20 C.F.R. 801.301(b).

[147] 33 U.S.C. § 921(b)(5); 20 C.F.R. 802.407(d) (1997).

[148] 33 U.S.C. § 921(b)(3).

Prior to a BRB decision, parties may file briefs, reply briefs, additional briefs, motions and in some cases, oral arguments can be had.[150] After a complete review of the proceedings, the BRB quickly issues a full, written decision detailing the issues and the law to the parties and the OWCP, while also forwarding the appeal record to the OWCP.[151] The BRB may affirm, modify, vacate, remand[152] or reverse.[153] The BRB decision is a "final order" when it finalizes the dispute and requires no court action save executing the decision.[154] However, a BRB decision remanding the case back to the ALJ is not usually a final order.[155] The concept of "final order" is important because only BRB final orders are eligible for appeal to the United States Courts of Appeal.[156]

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[149] *Id.*; 20 C.F.R. § 802.301(a); O'Keeffe v. Smith, Hinchman & Grylls Assocs., Inc., 380 U.S. 359, 362 (1965) (applying substantial evidence rule to LHWCA as required by APA). The BRB is required to accept the ALJ's findings unless they are irrational or unsupported by substantial evidence. Mijangos v. Avondale Shipyards, Inc., 948 F.2d 941, 944 (5th Cir. 1991). *See* Penrod Drilling Co. v. Johnson, 905 F.2d 84, 88 (5th Cir. 1990) (holding BRB cannot make its own factual determinations). The BRB is prohibited from employing *de novo* review. *Mijangos*, 948 F.2d at 944. Further, the BRB can not second guess an ALJ whose findings are premised on substantial evidence. Director, Office of Workers' Compensation Programs v. Jaffe New York Decorating, 25 F.3d 1080, 1084 (D.C. Cir. 1994); *see also* Associated Indem. Corp. v. Shea, 455 F.2d 913, 914 (5th Cir. 1972) (providing example of when evidence is substantial).

[150] 20 C.F.R. §§ 802.212-802.309 (1997).

[151] 20 C.F.R. §§ 802.403-802.404 (1997).

[152] 33 U.S.C. § 921(b)(4); 20 C.F.R. §§ 802.404(a), 802.405 (1997).

[153] 20 C.F.R. § 802.404(a).

[154] Bish v. Brady-Hamilton Stevedore Co., 880 F.2d 1135, 1137 (9th Cir. 1989). *Accord* Rivere v. Offshore Painting Contractors, 872 F.2d 1187, 1189-90 (5th Cir. 1989) (stating only BRB orders finalizing merits of administrative process are final orders).

[155] Newpark Shipbuilding & Repair, Inc. v. Roundtree, 723 F.2d 399, 406 (5th Cir. 1984) (holding BRB order deciding employer's LHWCA liability but remanding for additional proceedings is not final order).

[156] Midland Ins. Co. v. Adam, 781 F.2d 526, 528 (6th Cir. 1985) (holding final order is prerequisite to appeal).

4. Phase Four—Appellate Review by United States Circuit Courts

According to the LHWCA, "any person adversely affected or aggrieved by a final order" of the BRB can have his case reviewed in the United States Circuit Court for the circuit where the injury occurred.[157] The losing party has sixty days after the BRB order issuance to file an appeal.[158] If an appeal is not filed within sixty days, the BRB order becomes final.[159] The circuit courts have the power to render any decision—affirm, modify or set aside.[160] The circuit courts review BRB orders for adherence to the substantial evidence standard of review, errors of law and whether the factual findings were based upon substantial evidence in the ALJ's record.[161] However, the BRB is not accorded special deference regarding its statutory interpretation because the BRB is not a body designed for policymaking.[162]

VI. THE LAST-INJURIOUS-EXPOSURE RULE

Although the LHWCA and its agency regulations enunciate a comprehensive regulatory system, the positive law is vague, or gives no guidance at all, on several important issues. One of these important issues involves the assigning of liability when successive employers have exposed an employee to a long latency occupational disease. Upon whom should an ALJ pin the responsibility of paying compensation benefits when two maritime employers have exposed an employee to asbestos? After answering that question, an ALJ might also have to answer a related question: if the liable employer had more than one insurance carrier during the disabled employee's tenure, which carrier should pay the benefits on the employer's behalf? Neither the LHWCA nor the DOL regulations speak directly to this assignment of liability issue. Section 902(4), defining an employer, and section 904, discussing employer liability, provide no guidance to an ALJ or court faced with the issue. Therefore, the federal courts crafted the last-injurious-exposure rule to fill the statutory gap.[163] In *Travelers Insurance Co. v. Cardillo,*[164] the Second Circuit established the rule's foundation and theoretical underpinnings.[165] In *Cardillo*, the court introduced the last-injurious-exposure rule by stating,

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[157] 33 U.S.C. § 921(c); 20 C.F.R. § 802.410(a) (1997); Ingalls Shipbuilding, Inc. v. Director, Office of Workers' Compensation Programs, 117 S. Ct. 796, 804 (1997).

[158] 33 U.S.C. § 921(c); 20 C.F.R. § 802.410(a).

[159] 20 C.F.R. § 802.406 (1997).

[160] 33 U.S.C. § 921(c).

[161] Mendoza v. Marine Personnel Co., 46 F.3d 498, 500 (5th Cir. 1995); *Jaffe*, 25 F.3d at 1084; Port of Portland v. Director, OWCP, 932 F.2d 836, 838 (9th Cir. 1991).

[162] Port of Portland, 932 F.2d at 838. However, the Ninth Circuit also clearly indicated that deference should be accorded OWCP LHWCA interpretation. *Id. But see* Liberty Mut. Ins. Co. v. Commercial Union Ins. Co., 978 F.2d 750, 757 (1st Cir. 1992) (stating circuits are in conflict over whether OWCP interpretation should be given deference).

> the employer during the last employment in which the claimant was exposed to injurious stimuli, prior to the date upon which the claimant *became aware of the fact that he was suffering from an occupational disease* arising naturally out of his employment, should be liable for the full amount of the award.[166]

Because the employers in *Cardillo* had been successively insured by several carriers, the court alertly extended the rule to the insurance context when it held,

> the carrier who last insured the 'liable' employer during claimant's tenure of employment, prior to the date claimant

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[163] The last-injurious-exposure rule is also referred to as the last employer rule, the *Cardillo* rule, the occupational disease rule or the disease rule. United States Department of Labor, Office of Administrative Law Judges Law Library, *Judges' Benchbook: Longshore and Harbor Workers' Compensation Act*, Topic 70.1 (visited Feb. 1, 1998) <http://204.245.136.2/public/lgshore/refrnc/lsbk70.htm> [hereinafter *Benchbook*].

[164] 225 F.2d 137 (2d Cir. 1955).

[165] Although the circuit courts have split when interpreting *Cardillo's* phrasology, all courts cite approvingly to the premise it established. *See, e.g.,* Liberty Mut. Ins. Co. v. Commercial Union Ins. Co., 978 F.2d 750, 752-53 (1st Cir. 1992); General Dynamics Corp. v. Benefits Review Board, 565 F.2d 208, 211 (2nd Cir. 1977).

[166] *Cardillo*, 225 F.2d at 145 (emphasis added).

> became aware of the the [sic] fact that he was suffering from an occupational disease arising naturally out of his employment, should be held responsible for the discharge of the duties and obligations of the 'liable' employer.[167]

By adopting a rule which makes the last exposing employer liable for 100 percent of the compensation payments, even when a previous employer partially contributed to the disability, the Second Circuit rejected the concept of apportioning liability among all exposing employers which some state workers' compensation programs have adopted.[168]The court chose to hold only one employer liable because of the administrative burdens and delays associated with apportionment.[169] From a practical viewpoint, the Second Circuit believed the concept of occupational diseases and the lack of medical certainty surrounding their development made it administratively infeasible to link certain stages of the disease with particular work experiences.[170]

Since *Cardillo*, the circuit courts have reached an uneasy sense of agreement on most, but not all, of the last-injurious-exposure rule's five subparts. However, it is important to note that the BRB and all circuits presented with successive employer or carrier cases adhere to the idea of holding just one employer or carrier liable.[171]

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[167] *Id.*

[168] *See generally,* Russell G. Donaldson, Annotation, *Workers' Compensation: Liability of Successive Employers for Disease or Condition Allegedly Attributable to Successive Employments*, 34 A.L.R. 4th 958 (1984 and Supp. 1997) (collecting and analyzing cases supporting and rejecting apportionment of liability). Notably, the court also rejected the DOL's liability allocation formula to which employers and carriers consented from 1927 to 1955. *Cardillo,* 225 F.2d at 144. Prior to *Cardillo,* the DOL held:

> "the employer in the last employment during which the injurious and cumulative effects of the occupational exposure *manifested themselves*" principally liable, and holding "the carrier or carriers covering the employer during such last employment *jointly, severally and equally responsible* for the discharge of the duties and obligations of the last employer in respect of such liability."

Id. (emphasis added).

[169] *Cardillo,* 225 F.2d at 145. The court reviewed the LHWCA's legislative history and noted that Congress was presented with the idea of apportionment. *Id.* However, the court inferred from Congress's failure to include statutory language regarding apportionment an implicit recognition of the idea's administrative inefficiency. *Id.*

[170] *Id.* at 144. Regarding insurers, while the court admitted to "groping in the dark" to fashion a rule, it justified holding just one insurer liable on the concept of administrative ease also. *Id.* at 145.

A. *Exposure to an Injurious Stimuli*

As expressed in *Cardillo*, the last-injurious-exposure rule requires the liable employer to have exposed the employee to some sort of injurious stimuli.[172] However, whether the employers in *Cardillo* exposed the three shipyard workers to loud noises, which caused hearing loss, was not an issue on appeal.[173] Therefore, other circuits were left to flesh out the contours of this requirement.

In *Avondale Industries, Inc. v. Director, Office of Workers' Compensation Programs,*[174] the Fifth Circuit addressed this exposure element. In *Avondale*, the disabled employee worked full-time for Avondale Shipyards from 1960-1967 as a crane operator and welder, and he was exposed constantly to loud noises generated by work-related machinery.[175] In 1971, the employee began work as a stevedore at Sealand's Gulfport, Mississippi facility.[176] Later, in 1986, after leaving Sealand, the employee received a hearing exam which indicated substantial hearing loss.[177] Thereafter, the employee filed a LHWCA claim for occupational hearing loss against Avondale, his first employer.[178] Avondale controverted the claim on the grounds that it was not the last employer to expose the employee to an injurious stimuli, loud noise.[179] The BRB and the Fifth Circuit affirmed the ALJ's determination that Avondale was the liable employer.[180] While Avondale was not the last employer in fact, the Fifth Circuit determined Avondale to be the last injurious employer because the evidence demonstrated no injuriously loud noise exposure at Sealand.[181] Although the Fifth Circuit refused to reverse the ALJ's finding that no injurious stimuli existed at Sealand, the second employer, the court approvingly recognized a previous Fifth Circuit case which held, "regardless of the brevity of the exposure, if it has potential to cause disease, it is considered injurious."[182] Further, the court suggested that the last-injurious-exposure rule could produce inequitable results when the employee works only briefly for the last employer.[183]

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[171] Liberty Mut. Ins. Co. v. Commercial Union Ins. Co., 978 F.2d 750, 652 (1st Cir. 1992); Argonaut Ins. Co. v. Patterson, 846 F.2d 715, 718-19 (11th Cir. 1988); Fulks v. Avondale Shipyards, Inc., 637 F.2d 1008, 1012 (5th Cir. 1981); Cordero v. Triple A Mach. Shop, 580 F.2d 1331, 1337 (9th Cir. 1978); General Dynamics Corp. v. Benefits Review Bd., 565 F.2d 208, 209 (2d Cir. 1977).

[172] *Cardillo*, 225 F.2d at 145.

[173] *Id.* at 140-42.

[174] 977 F.2d 186 (5th Cir. 1992).

[175] *Avondale*, 977 F.2d at 188.

[176] *Id.* At Sealand, the employee unloaded bananas from a rubber conveyor belt on a part-time basis. *Id.* Occasionally, a noise-creating forklift operated near the conveyor belt. *Id.*

[177] *Id.*

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[178] *Id.*

[179] *Id.* at 189. Avondale agreed that the employee was exposed to harmful noise while in its employ. *Id.* at 190.

[180] *Avondale*, 977 F.2d at 189, 192.

[181] *Id.* at 192. At the ALJ's formal hearing, the employee "testified that the noise at Avondale's shipyard was so loud that 'you couldn't hardly hear yourself talk.'" *Id.* at 191. Contrastingly, the employee testified that the noise at Sealand was "just like around town, standing on the corner." *Id.*

[182] *Id.* at 190 (citing Fulks v. Avondale Shipyards, Inc., 637 F.2d 1008, 1012 (5th Cir. Feb. 1981)). In *Fulks*, the employer requested the establishment of a de minimis standard so that short exposures to an injurious stimuli would not trigger liability; the BRB and the court refused to establish such a standard. *Fulks*, 637 F.2d at 1012.

[183] *Avondale*, 977 F.2d at 190. The Ninth Circuit also has been active in development of case law on the injurious stimuli element. *See* Port of Portland v. Director, Office of Workers Compensation Programs, 932 F.2d 836, 840 (9th Cir. 1991) (exonerating employer who hired employee four days after hearing test because no rational connection between disease's development and employment existed); Todd Pacific Shipyards Corp. v. Director, Office of Workers Compensation Programs, 914 F.2d 1317, 1320 (9th Cir. 1990) (stating employer must expose employee to quantities of asbestos significant enough to cause asbestosis in order to be liable).

B. Occupational Diseases Only

When fashioning the last-injurious-exposure rule, the *Cardillo* court spoke only about occupational diseases, not traumatic injuries.[184] This has led the BRB and most circuits to apply the rule solely in occupational disease cases.[185] For example, in *Foundation Constructors, Inc. v. Director, Office of Workers Compensation Programs*, the Ninth Circuit refused to apply the rule to a work-related back condition because it was strictly reserved for occupational disease cases.[186] While the LHWCA does not define occupational disease, one commentator concluded that the following three scenarios give rise to one: 1) the affliction is categorized as an industrial disease because the employee's work environment gives him contact with an injurious stimuli and increases the probability that he will contract the disease, 2) the employee's work site aggravated an existing disease or 3) "the disease is an ordinary disease of life, but was contracted at work under unusual circumstances that increased the claimant's risk of contracting the disease."[187] Courts or the BRB have classified asbestosis,[188] silicosis,[189] heart disease,[190] bronchitis,[191] lung cancer[192] and bronchial asthma[193] as occupational diseases, among other things.

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[184] *Cardillo*, 225 F.2d at 145. *Cardillo* was a noise-induced hearing loss case, and traditionally hearing loss was considered an occupational disease, rather than a traumatic injury. *Benchbook*, *supra* note 163, topic 70.4; *see also Avondale*, 977 F.2d at 190 (treating noise-induced hearing loss as occupational disease as recently as 1992). However, in 1993, the United States Supreme Court classified hearing loss as an injury. Bath Iron Works v. Director, Office of Workers' Compensation Programs, 506 U.S. 153, 163 (1993). While *Bath Iron Works* surely undermines the Second and Fifth Circuits' decision to categorize hearing loss as a disease, the opinion did not address the last-injurious-exposure rule. Therefore, the efficacy of the rule itself when applied to legitimate occupational diseases was not questioned or mentioned by the Court.

[185] *Benchbook*, *supra* note 163, topic 70.2.

[186] Foundation Constructors, Inc. v. Director, Office of Workers Compensation Programs, 950 F.2d 621, 624 (9th Cir. 1991). However, the Ninth Circuit acknowledged that the rule had "sprouted a branch" applicable to certain injury cases. *Foundation*, 950 F.2d at 623 (citing Kelaita v. Director, Office of Workers' Compensation Programs, 799 F.2d 1308, 1311 (9th Cir. 1986)). This new branch is often called the aggravation or two-injury rule. *Id.* at 623-24. But the court clearly stated that the original last-injurious-exposure rule and the two-injury rule were applied in different situations and required the application of two different tests. *Id.*

[187] Junius C. McElveen, Jr. & Lawrence P. Postol, *Compensating Occupational Disease Victims under the Longshoremen's and Harbor Workers' Compensation Act*,

C. Employers Subject to the LHWCA

The appellants in *Cardillo* did not ask the Second Circuit to review whether the employers in the case were "maritime" employers subject to the requirements of the LHWCA.[194] Therefore, the court announced the last-injurious-exposure rule in the context of employers and carriers who stipulated to being maritime employers with LHWCA responsibilities. Since *Cardillo*, questions have arisen as to how the rule applies to an employee exposed to an occupational disease by a maritime employer and subsequently exposed by a non-maritime employer.

In *Todd Shipyards Corp. v. Black*, the employee first worked for Todd Shipyards, a maritime employer, from 1942-1945, and in his job as a welder he was exposed to asbestos.[195] Later, the employee worked for Boeing Aircraft Corporation, a non-maritime employer, from 1951-1977, where he also was exposed to asbestos.[196] After a doctor diagnosed as-

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32 AM. U. L. REV. 717, 725 (1983). The Second Circuit defined occupational disease as "any disease arising out of exposure to harmful conditions of employment, when those conditions are present in a peculiar or increased degree by comparison with employment generally." Gencarelle v. General Dynamics Corp., 892 F.2d 173, 176 (2d Cir. 1989).

[188] *Bath Iron Works*, 506 U.S. at 164.

[189] Argonaut Ins. Co. v. Patterson, 846 F.2d 715, 723 (11th Cir. 1988).

[190] Crum v. General Adjustment Bureau, 738 F.2d 474, 478 (D.C. Cir. 1984).

[191] Cordero v. Triple A. Mach. Shop, 580 F.2d 1331, 1335 (9th Cir. 1978).

[192] General Dynamics Corp. v. Benefits Review Bd., 565 F.2d 208, 210 (2d Cir. 1977).

[193] Thorud v. Brady Hamilton Stevedore Co., 18 Ben. Rev. Bd. Serv. (MB) 232, 233 (1986).

[194] *Cardillo*, 225 F.2d at 140-42. *See supra* note 12 and accompanying text (detailing who is maritime employer subject to LHWCA).

[195] Todd Shipyards Corp. v. Black, 717 F.2d 1280, 1282-83 (9th Cir. 1983). The employee testified that asbestos "was all over. You had to wallow in it to do your welding. . . ." *Black*, 717 F.2d at 1283.

[196] *Id.* The Boeing exposure to asbestos was "off and on." *Id.*

bestosis, the employee filed a LHWCA claim against Todd Shipyards, the first exposing employer.[197] Todd Shipyards controverted the claim on the theory that the employee's twenty-six year tenure at Boeing erased its liability, among other things.[198] The ALJ and the BRB held Todd Shipyards liable to pay compensation benefits,[199] and the Ninth Circuit affirmed.[200] After citing *Cardillo* with approval, the Ninth Circuit rejected Todd Shipyard's argument that the last-injurious-exposure rule foisted liability onto Boeing.[201] Instead the court forcefully stated that a maritime employer could not shirk its LHWCA duties because a subsequent non-maritime employer, Boeing, contributed to the disease.[202] Moreover, the court opined,

> [t]he last covered employer rule means, plainly and simply, that the last employer covered by the LHWCA who causes or contributes to an occupational injury is completely liable for that injury. This is true even if the employee incurred the injury, in part, while subsequently working for an employer not covered by the Act [LHWCA].[203]

In clarifying that the rule applies only to maritime employers, the Ninth Circuit suggested that it was adopting an approach uniformly approved by other circuits and the BRB.[204]

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[197] *Id.* Fireman's Fund Insurance Company was Todd Shipyard's insurance carrier. *Id.*

[198] *Id.*

[199] *Id.* at 1282. The ALJ presumed Boeing was not a maritime employer because Todd Shipyards presented no evidence that Boeing satisfied the section 902(4) employer status test and did not join Boeing as a party. *Id.* at 1283 n.1.

[200] *Black*, 717 F.2d at 1282.

[201] *Id.* at 1285. The court believed that Todd Shipyards's interpretation of the rule would deprive employees exposed to injurious stimuli compensation benefits if they subsequently worked for non-maritime employers. *Id.*

[202] *Id.*

[203] *Black*, 717 F.2d at 1287.

[204] *Id.* at 1285. *See* Fulks v. Avondale Shipyards, Inc., 637 F.2d 1008, 1012 (5th Cir. 1981); Green v. Newport News Shipbuilding & Dry Dock Co., 13 Ben. Rev. Bd. Serv. (MB) 562, 565 (1981) *vacated on other grounds*, 688 F.2d 833 (4th Cir. 1982). *But see* McElveen & Postol, *supra* note 187, at 761-64 (criticizing Ninth Circuit for limiting rule to maritime employers only and criticizing court for relying upon factually distinguishable *Fulks* and *Green*). *See generally*

D. Employers and Insurance Carriers

Section 932 of the LHWCA allows maritime employers to buy insurance to cover their compensation responsibilities.[205] Therefore, after the *Cardillo* court crafted the last-injurious-exposure rule to allocate employer liability, the court quickly recognized the practical need to mold the rule to insurance carriers.[206] However, as logic dictates, the essential elements of the rule as applied to employers and carriers are identical.[207] Hence, *Cardillo* insists upon a two step analysis: (1) determine the liable employer and then (2) ask which carrier last insured that employer during the employee's tenure prior to the date of awareness.[208]

The BRB and the courts have applied the rule uniformly to employers and carriers and have followed *Cardillo's* basic formulation.[209] For example, in *Maes v. Barrett & Hilp*, an insurance carrier case, the BRB determined that in assessing employer or carrier liability there was just one rule to consider.[210] After citing *Cardillo* with approval, the BRB concluded that "the last employer or carrier to expose the employee to injurious stimuli prior to his awareness of his occupational disease is liable for compensation."[211]

Benchbook, *supra* note 163, topic 70.6 (supporting Ninth Circuit and not citing any cases contrary to *Black*).

[205] *See supra* notes 16-18 and accompanying text.

[206] *Cardillo*'s factual circumstances forced the Second Circuit to address the liable carrier problem. *Cardillo* was a consolidation of three cases in which each maritime employer was represented by three separate insurance carriers during the disabled employees' tenures. *Cardillo*, 225 F.2d at 140-41.

[207] Regarding carrier liability, the Second Circuit concluded that Congressional intent dictated a rule for carriers similar to the rule for employers. *Id.* at 145.

[208] *Id.*

[209] "A determination as to which employer is liable, and when liability attaches under the applicable last employer rule, determines which carrier is liable. The carrier on the risk when the employer's liability attaches is responsible." *Benchbook*, *supra* note 163, topic 70.12.

[210] Maes v. Barrett & Hilp, 27 Ben. Rev. Bd. Serv. (MB) 128, 131 (1993). The BRB always spoke in the singular to amplify that only one substantive rule existed. *Maes*, 27 Ben. Rev. Bd. Serv. (MB) at 131 (giving examples of singular form).

[211] *Id.*; *see also* Liberty Mut. Ins. v. Commercial Union Ins. Co., 978 F.2d 750, 752 (1st Cir. 1992) (supporting basic proposition that last-injurious-exposure rule

E. The Trigger—The Date of Awareness or the Date of Disability

When applying the last-injurious-exposure rule, one of the most difficult problems confronting ALJs, the BRB and the courts is whether the date of awareness or the date of disability should trigger liability. Remember *Cardillo's* formulation held liable the last exposing employer "prior to the date upon which the claimant became aware of the fact that he was suffering from an occupational disease."[212] Under this awareness test formulation, the employee's date of awareness becomes a critical determination upon which liability for all compensation rests. In situations in which the date of awareness differs from the date of disablement, results seemingly contradictory to the basic premise of the rule can be reached.[213]

While the Second Circuit adhered to the same *Cardillo* formula in 1977,[214] beginning in 1978, a steady drum beat of circuit opinions began to call into question the use of the awareness test.[215] The most recent and inciteful opinion, *Lib-*

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applies uniformly to employers and carriers); Argonaut Ins. Co. v. Patterson, 846 F.2d 715, 718 (11th Cir. 1988) (same).

[212] *Cardillo*, 225 F.2d at 145.

[213] Hypothetically, maritime employer #1 could expose a shipyard welder to asbestos on March 13, 1985, and the welder's doctor could make him aware of early stages of asbestosis on March 13, 1995. Yet if the welder switches jobs and begins working for maritime employer #2 which also exposes him to asbestos, and he becomes disabled on March 13, 1998, maritime employer #1 is liable, even though it is not the last exposing maritime employer.

[214] General Dynamics Corp. v. Benefits Review Bd., 565 F.2d 208, 210 (2d Cir. 1977) (applying *Cardillo's* awareness test patently when dates of awareness and disability coincide). "The key date is the time the claimant was made aware that his ailment was job-related and not the time that his health became impaired." *General Dynamics*, 565 F.2d at 211. Although this above statement distinguishes between the date an employee incurred an occupational disease and the date of awareness, it is strong evidence that the Second Circuit would still apply the awareness test when the date of awareness varies from the date of disability. *See Benchbook*, *supra* note 163, topic 70.2 (stating Second Circuit adheres to *Cardillo* but has not addressed last-injurious-exposure rule since adjustments by other circuits).

[215] Liberty Mut. Ins. Co. v. Commercial Union Ins. Co., 978 F.2d 750, 753 (1st Cir. 1992) (discussed in text); Argonaut Ins. Co. v. Patterson, 846 F.2d 715, 719-20 (11th Cir. 1988) (discussed *infra* note 231); Cordero v. Triple A. Mach. Shop,

erty Mutual Insurance Co. v. Commercial Union Insurance Co., flatly rejected the awareness test and adopted the date of disability as the liability trigger.[216] In *Liberty Mutual*, an employee worked for Bath Iron Works for forty-four years, from 1941-1985, and was exposed to asbestos.[217] Although a doctor made the employee aware that he had asbestosis in December, 1980, the employee was able to continue working until February 13, 1985, his date of disablement.[218] As of the awareness date, December, 1980, Commercial Union provided the employer with LHWCA insurance.[219] However, the employer switched insurance carriers on March 1, 1981, prior to the disablement date, and Liberty Mutual jumped on board the risk.[220] Consequently, a unique situation was presented. If the last-injurious-exposure rule was triggered by the date of awareness, as suggested by a literal interpretation of *Cardillo*, Commercial Union had responsibility to pay the compensation. However, if the rule was triggered by the date of disablement, as *Cordero* suggested, Liberty Mutual was liable. In a vivid, salty and well-reasoned opinion, the First Circuit held the date of disablement more appropriate, and re-formulated the rule by stating, "the carrier which last insured the liable employer during the period in which the claimant was exposed to injurious stimuli and prior to *the date the claimant became disabled* by an occupational disease arising naturally out of his employment and exposure is responsible for discharging the duties and obligations of the liable employer."[221] The court rejected

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580 F.2d 1331, 1337 (9th Cir. 1978) ("Because the onset of disability is a key factor in assessing liability under the last-injurious-exposure rule, it does not detract from the operation of this rule to show that the disease existed under the prior employer or carrier, or had become actually apparent, or had received medical treatment, so long as it had not resulted in disability").

[216] *Liberty Mut.*, 978 F.2d at 757.

[217] *Id.* at 751.

[218] *Id.*

[219] *Id.*

[220] *Id.*

[221] *Liberty Mut.*, 978 F.2d at 756 (emphasis added). The court affirmed the ALJ and BRB's decision that Liberty Mutual was the carrier responsible for paying compensation. *Id.* at 751.

the awareness test and adopted the date of disablement for five reasons. First, the court distinguished the *Liberty Mutual* facts from the *Cardillo* facts.[222] The court noted that while the awareness date and the disability date were the same in *Cardillo*, the dates did not coincide in *Liberty Mutual*.[223] Therefore, the court did not feel *Cardillo* had high precedential value on the narrow question before it,[224] but the court also believed that the disablement test better served the administrative efficiency goals *Cardillo* sought to achieve.[225] Second, the court reasoned that the disability test required an easier, less uncertain medical diagnosis of a present condition.[226] Third, the First Circuit observed that the date of disability "readily lends itself to objective means of proof, encounters fewer factual obstacles, and more smoothly implements the LHWCA."[227] Fourth, the court interpreted the same 1926 Congressional hearings cited in *Cardillo* to support a disability test rather than an awareness test.[228] Fifth, the court determined that the 1984 LHWCA amendments, which modified Sections 912 and 913's occupational disease statute of limitations to include a disability component, supported Congress's desire to have the date of disability play a high profile role.[229]

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[222] *Id.* at 752.

[223] *Id.*

[224] *Id.* By distinguishing the facts, the court implicitly suggests that nothing turned on the date of awareness in *Cardillo*. In addition, one commentator suggested that the First Circuit thought the *Cardillo* court would have articulated the rule differently had the dates not coincided. Erin L. Dailey, *Topical Survey Insurance Law—All Carriers Will be the Last Carrier Their Proportionate Share of the Time*—Liberty Mut. Insurance Co. v. Commercial Union Insurance Co., 978 F.2d 750 (1st Cir. 1992), 27 SUFFOLK U. L. REV. 1128, 1130 n.17 (1993).

[225] *Liberty Mut.*, 978 F.2d at 752.

[226] *Id.* at 753. Whereas, the court concluded that an awareness test required a more speculative diagnosis and prediction of the occupational disease's progression. *Id.* The First Circuit jested that a crystal ball would be needed under an awareness test. *Id.*

[227] *Id.*

[228] *Id.* at 754.

[229] *Id.* After the 1984 amendments, the occupational disease notice of injury statute of limitations begins to run upon the employee's awareness of the nexus between the employment, the disease and the disability; prior to 1984, the statute of limitations began to run upon awareness of the nexus between the injury and

Moreover, the First Circuit stated that the only other circuit directly faced with the awareness versus disability dilemma favored the disability test.[230]

Although the First Circuit presented the most persuasive arguments for a date of disability formulation of the last-injurious-exposure rule, the concept of awareness seems embedded in the Second Circuit's original formulation of the rule. Additionally, it seems almost hypocritical to endorse distinct parts of the *Cardillo* formula while simultaneously rejecting the awareness component. Given *Cardillo's* seminal status in this area of Longshore law, the awareness test hardly seems abandoned. To solve this puzzle so as to provide some uniformity for employers and carriers doing business in several circuits, three solutions exist: judicial, congressional or administrative adoption of the date of disability trigger. Given that the United States Supreme Court denied certiorari in *Cardillo* and *Cordero*, it seems unlikely that the Court will address the intricacies of the rule any time soon. Similarly, the LHWCA has been through two major congressional overhauls since *Cardillo*, yet Congress has remained silent on the rule. Therefore, the best avenue, and possibly the only avenue, for unifying the approaches taken to successive employer and carriers liability problems is an administrative one. The DOL via the OWCP should invoke its rule-making authority in order to announce a uniform last-injurious-exposure rule, preferably encompassing the administratively simpler date of disability trigger. Employers, carriers, employees, ALJs and the OWCP itself would benefit from a fixed and formally announced rule.

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the employment. *Id.* Similar changes were made to section 913. *Id.* While the First Circuit recognized that it was rationalizing a judicially-created rule upon the congressional intent of entirely different statutes, the court believed this legislative history useful to understanding the appropriate course of action in an unsettled area of the law. *Id.* at 755.

[230] *Liberty Mut.*, 978 F.2d at 755 (citing Argonaut Ins. Co. v. Patterson, 846 F.2d 715, 719-20 (11th Cir. 1988)). In *Argonaut*, the Eleventh Circuit held the disability test proper because the word "suffering" in *Cardillo's* formulation, although undefined, connoted disability. *Argonaut*, 846 F.2d at 719. Further, the First Circuit opined that the disability test jibed more closely with the idea of suffering than did the awareness test. *Liberty Mut.*, 978 F.2d at 756.

VII. CONCLUSION

The LHWCA is a unique regulatory and adjudicating scheme which draws on administrative law, traditional workers' compensation principles and ancient admiralty concepts. Although the LHWCA and its regulations provide intricate and detailed guidelines which define the duties of maritime employers and the benefits inuring to injured maritime employees, the courts are faced with many legal puzzles embedded in the complexities and the fissures in the positive law. One such problem area involves assigning liability when multiple maritime employers expose an employee to an occupational disease. While the courts have developed several competing versions of the last-injurious-exposure rule to tackle the problem, the agency responsible for administering the LHWCA should provide a more uniform, brighter beacon by which all parties may steer.

John Braley

APPENDIX A

DESCRIPTION: ORGANIZATIONAL STRUCTURE OF AGENCY ADMINISTERING THE LHWCA

LOCATION: HTTP://GATEKEEPER.DOL.GOV/DOL/ESA/PUBLIC/CONTACTS/OWCP/LSCONTAC.HTM

UNITED STATES DEPARTMENT OF LABOR (DOL)

- EMPLOYMENT STANDARDS ADMINISTRATION (ESA)
  - OFFICE OF WORKERS' COMPENSATION PROGRAMS (OWCP)
    - DIVISION OF LONGSHORE AND HARBOR WORKERS' COMPENSATION

PROGRAM AND DISTRICT OFFICE PERSONNEL

JOSEPH F. OLIMPIO
DIRECTOR
MICHAEL E. CONDRON
DEPUTY DIRECTOR

REGION I--BOSTON
(CONNECTICUT, MAINE, MASSACHUSETTS, NEW HAMPSHIRE, RHODE ISLAND, VERMONT)

BOSTON LONGSHORE DISTRICT OFFICE
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ESA/OWCP/DLHWC
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REGION II--NEW YORK
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REGION III--PHILADELPHIA
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REGION VI--DALLAS
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REGION IX--SAN FRANCISCO
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EMINENT DOMAIN: SHOULD AN EXPERT'S APPRAISAL REPORT BE SUBJECT TO PRETRIAL DISCOVERY?

I. INTRODUCTION

When the federal government condemns private property for public use pursuant to the Fifth Amendment of the United States Constitution, it must give the landowner just compensation.[1] Under article III of the Mississippi Constitution, private property may not be taken for public use unless the landowner receives due compensation.[2] Mississippi statutory law defines who may exercise the right of eminent domain.[3] In addition to condemnation power, statutes define which governmental entities may exercise the right of immediate possession, including the State Highway Commission, counties, and municipal authorities.[4]

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[1] U.S. CONST. amend. V ("[N]or shall private property be taken for public use, without just compensation.").

[2] MISS. CONST. art. III, § 17 (1890) ("Private property shall not be taken or damaged for public use, except on due compensation being first made to the owner or owners thereof. . . . ").

[3] MISS. CODE ANN. § 11-27-1 (1972) ("Any person or corporation having the right to condemn private property for public use shall exercise that right as provided in this chapter, except as elsewhere provided under the laws of the state of Mississippi.").

[4] MISS. CODE ANN. § 11-27-81 (Supp. 1997). Section 11-27-81 states:

> The right of immediate possession pursuant to Sections 11-27-81 through 11-27-89, Mississippi Code of 1972, may be exercised only:
>
> (a) By the State Highway Commission for the acquisition of highway rights-of-way only;
>
> (b) By any county or municipality for the purpose of acquiring rights-of-way to connect existing roads and streets to highways constructed or to be constructed by the State Highway Commission;
>
> (c) By any county or municipality for the purpose of acquiring rights-of-way for widening existing roads and streets of such county or municipality, provided, however, that said rights-of-way shall not displace a property owner from his dwelling or place of busi-

When these statutorily authorized persons and corporations condemn private property, they often dispute with the landowners over the value of just compensation.[5] In fact, what constitutes due compensation is often the sole issue in an eminent domain proceeding.[6] Commonly, the government and the landowner employ expert appraisers who value the subject property to determine its highest and best use.[7] In Mississippi, the Special Court of Eminent Domain may appoint a disinterested appraiser to render an opinion on the just compensation value of the subject property.[8] Within ten days of this appointment, the appraiser must submit a written report to the court.[9] However, the Mississippi Rules of Evi-

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> ness;
> (d) By the boards of supervisors of any county of this state for the acquisition of highway or road rights-of-way in connection with a state-aid project designated and approved in accordance with Sections 65-9-1 through 65-9-31, Mississippi Code of 1972;
> (e) By the Mississippi Wayport Authority for the purposes of acquiring land and easements for the Southeastern United States Wayport project as authorized by Sections 61-4-1 through 61-4-13, Mississippi Code of 1972;
> (f) By any county or municipality for the purpose of acquiring rights-of-way for water, sewer, drainage and other public utility purposes; provided, however, that such acquisition shall not displace a property owner from his dwelling or place of business; or
> (g) By any county authorized to exercise the power of eminent domain under Section 19-7-41 for the purpose of acquiring land for construction of a federal correctional facility or other federal penal institution.

Id.

[5] Note, *Condemnation in Indiana: Discovery of Expert Appraisal Reports*, 8 VAL. U.L. REV. 409, 412-14 (1974).

[6] Claire K. McCurdy & Nina M. Thompson, *What is Eminent Domain and How Do You Do It?*, 61 J. KAN. BAR ASS'N 24, 27 (1992).

[7] *Id.* at 29-30.

[8] MISS. CODE ANN. § 11-27-83 (Supp. 1997).

[9] *Id.* Section 11-27-83 states:

> The appraiser, after viewing the property, shall return to the clerk of court within ten (10) days after his appointment, his report in triplicate, under oath, which report shall state: (1) the fair market value of the property to be condemned, determined as of the date of the filing of the complaint; (2) the damages, if any, to the remainder if less than the whole is taken, giving a total compensation and damages to be due as

dence prohibit these court-appointed appraisers from testifying at the eminent domain trial and further prohibit the appraiser's report from being admitted into evidence.[10]

While there are clear evidentiary and discovery rules relating to court-appointed appraisers, there is a lack of uniformity in the rules relating to appraisal experts hired by the litigating parties. This comment will focus on the scope of discovery practices in eminent domain proceedings and will emphasize whether expert appraisal reports are or should be discoverable. Since the Mississippi Supreme Court has never squarely confronted the issue of whether the opposing party's appraisal report is subject to discovery, this comment will utilize case and statutory laws from other jurisdictions to critique the various reasons for and against production of expert appraisal reports.

II. PRETRIAL DISCOVERY IN MISSISSIPPI EMINENT DOMAIN PROCEEDINGS

If eminent domain statutes do not define the procedures which govern in condemnation trials, courts typically use general civil procedure rules. For example, pursuant to Rule 81 of the Mississippi Rules of Civil Procedure, the discovery rules embodied in Rules 26 through 37 apply to eminent do-

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> determined by the appraiser; and (3) his opinion as to the highest and best use of the property, and a narrative of the facts pertaining to his appraisal.

Id.

[10] MISS. R. EVID. 601(c) ("A person appointed by a court as required by state law to make an appraisal in an eminent domain proceeding for the immediate possession of land shall not be eligible to testify in the trial of such case, and the report of such court appointed appraiser shall not be admissible in evidence during such trial."). *See also* MISS. R. EVID. 706 (stating that court-appointed appraisers cannot be deposed or called as witnesses at trial); Hudspeth v. State Highway Comm'n, 534 So. 2d 210, 213 (Miss. 1988) (amending Mississippi Rules of Evidence to preclude court-appointed appraisers from being competent witnesses in eminent domain trials).

The *Hudspeth* court explained the reasoning behind this prohibition as follows: "to prevent a jury from looking upon such testimony with a higher degree of trust and considering such testimony to be more credible since the appraiser was appointed by the court." *Hudspeth*, 534 So. 2d at 212.

main proceedings.[11] How liberally these civil discovery rules should be applied in eminent domain proceedings has been determined on a case-by-case basis in Mississippi courts.

A. Mississippi Civil Discovery Rules

A familiar maxim is that discovery rules should be liberally construed since trial by ambush is no longer the guiding principle in civil litigation.[12] However, discovery rules cannot address every discovery dispute that arises between litigants, leaving courts free to fashion their own procedures.[13] The Mississippi Rules of Civil Procedure provide limited guidance for discovery in eminent domain proceedings.

Specifically, Rule 26 permits parties to obtain discovery through depositions, interrogatories, production of documents, and requests for admissions.[14] Subsection (b) of Rule 26 defines the scope of such discovery to matters relevant to the issues unless the material is privileged.[15] If a party opposes a discovery request, that party bears the burden of proving that the material requested is protected by some privilege.[16]

Materials prepared in anticipation of litigation are not per se protected, for Rule 26(b)(3) permits discovery of such materials if the requesting party shows he has "substantial need of the materials prepared in the preparation of his case and that he is unable without undue hardship to obtain the substantial equivalent of the materials by other means."[17] Likewise, discovery of an expert's facts and opinions may be obtained through interrogatories designed to elicit a summary of the expert's proposed testimony at trial.[18] Further discovery may be ordered by the court upon a party's motion.[19] As such, under Rule 37, a court may order a nonresponsive party to produce documents, to respond to written interrogatories, or to answer questions posed in an oral deposition.[20]

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[11] MISS. R. CIV. P. 81 (stating that civil procedure rules apply to eminent domain proceedings except when statute specifically governs the procedures). *See also* State Highway Comm'n v. Jones, 649 So. 2d 201, 203 (Miss. 1995) (confirming that general civil discovery rules apply in eminent domain proceedings).

[12] Nichols v. Tubb, 609 So. 2d 377, 384 (Miss. 1992). *See also* FLEMING JAMES, JR. ET AL., CIVIL PROCEDURE § 5.2 (4th ed. 1992) (explaining that broad discovery facilitates production of evidence and reduces risks of parties fabricating evidence).

[13] *Hudspeth*, 534 So. 2d at 213. *See* Newell v. State, 308 So. 2d 71, 76 (Miss. 1975) (noting that Mississippi Supreme Court has inherent power to make procedural rules).

[14] MISS. R. CIV. P. 26(a).

[15] MISS. R. CIV. P. 26(b).

[16] Haynes v. Anderson, 597 So. 2d 615, 618 (Miss. 1992).

B. *Mississippi Case Law Addressing Discovery Requests in Eminent Domain Proceedings*

When mere application of discovery rules do not resolve specific pretrial disputes, Mississippi case law supplies additional guidance as to the scope of discovery in condemnation actions. In *State Highway Commission v. Havard*[21] for example, the Mississippi Supreme Court addressed the issue of discovery in eminent domain proceedings. The Mississippi State Highway Commission (MSHC) condemned the Havards' property in order to expand Highway 98 to four lanes.[22] Both the government and the landowners hired expert appraisers to determine just compensation.[23] In order to discover the basis of the landowners' expert's appraisal, the MSHC propounded interrogatories to the Havards.[24] The MSHC did not seek a court order to compel further discovery after it received the Havards' brief answers to the interrogatories, but MSHC did object to the expert's testimony at trial since the basis of it was not disclosed in pretrial practices.[25] Clarifying the scope of discovery in eminent domain trials, the court stated that "comparable sales to be used by either party . . . are properly subjects of discovery—provided the rules of discovery are correctly employed."[26] While the Havards' response to the interrogatories constituted a brief summary of their expert's testimony, the court concluded that the MSHC should have sought additional information either through a Rule 37 motion to compel or through more detailed interrogatories.[27]

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[17] MISS. R. CIV. P. 26(b)(3).

[18] MISS. R. CIV. P. 26(b)(4)(A)(I). It states:

> A party may through interrogatories require any other party to identify each person whom the other party expects to call as an expert witness at trial, to state the subject matter on which the expert is expected to testify, and to state the substance of the facts and opinions to which the expert is expected to testify and a summary of the grounds for each opinion.

Id. As long as the material sought is relevant and not privileged, discovery of facts and opinions held by experts, even though prepared in anticipation of litigation, may be obtained through interrogatories. MISS. R. CIV. P. 26(b)(4).

The rules do make an important distinction, however, between experts expected to testify at trial and experts who are not expected to testify. In Rule 26(b)(4)(B), the party seeking discovery of the facts and opinions of experts not expected to testify may only be obtained upon a "showing of exceptional circumstances under which it is impracticable for the party seeking discovery to obtain facts or opinions on the same subject by other means." MISS. R. CIV. P. 26(b)(4)(B).

[19] MISS. R. CIV. P. 26(b)(4)(A)(ii). The only restriction on further discovery under Rule 26(b)(4) is subsection (b)(4)(C), which provides that the party seeking discovery may be required to pay the expert a reasonable fee and a portion of the opposing counsel's fee for time spent in discovery. MISS. R. CIV. P. 26(b)(4)(C).

[20] MISS. R. CIV. P. 37.

[21] 508 So. 2d 1099 (Miss. 1987).

Prior to deciding *Havard*, the Mississippi Supreme Court concluded in *Barrett v. State Highway Commission* that a landowner should be given pretrial access to information prepared by the State Highway Commission.[28] The trial court denied discovery of the commission's blueprints and other evidence, which the court stated could have aided the landowners in preparing for trial.[29] The court reversed and remanded the case since the trial court committed harmful error by not extending the civil discovery rules to the condemnation action.[30]

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[22] *Havard*, 508 So. 2d at 1100.

[23] *Id.* at 1101.

[24] *Id.* at 1103.

[25] *Id.*

[26] *Id.* at 1104.

[27] *Havard*, 508 So. 2d at 1104. The court did not discuss the discoverability of experts' appraisal reports, however, since neither party raised the issue. *Id.*

[28] Barrett v. State Highway Comm'n, 385 So. 2d 627, 628 (Miss. 1980).

[29] *Barrett*, 385 So. 2d at 628. Likewise, in *United States v. 23.76 Acres of Land*, a federal district court in Maryland concluded that the government's real estate appraiser must answer deposition questions which were designed to elicit his opinions. United States v. 23.76 Acres of Land, 32 F.R.D. 593, 596 (D. Md. 1963). The court held that compelling the expert's testimony was necessary since the landowners had no other means of obtaining the evidence of value and the expert's computations. *23.76 Acres of Land*, 32 F.R.D. at 596. Under Maryland law, the court noted that "full discovery as to expert witnesses is permitted in

In an older decision, the Mississippi Supreme Court explained the standard for compelling expert testimony in an eminent domain trial. In *Paulk v. Housing Authority of City of Tupelo*, the Municipal Housing Authority of Tupelo condemned Paulk's property in an urban renewal project area.[31] Paulk had propounded numerous interrogatories to the Housing Authority in order to obtain information relating to their expert's appraisal opinions and to comparable sales.[32] The court upheld the trial court's suppression of the interrogatories because the trial court has discretion in discovery matters.[33] The court, however, boldly stated: "Ordinarily discovery of the expert opinions of an opposing party's expert witness will not be permitted, except in instances of extreme need by the examining party and inability on his part to obtain expert opinion on the same matter from other sources."[34] Since this case has never subsequently been cited for this proposition, the Mississippi Supreme Court may not hold itself

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condemnation cases, and the results have been that the issues are sharpened and pointed, trial time is reduced, and settlements are encouraged." *Id.* at 597.

[30] *Barrett*, 385 So. 2d at 628. Without defining the scope of discovery in eminent domain proceedings, the Mississippi Supreme Court remanded other cases where the trial court unduly restricted discovery. *See* State Highway Comm'n v. Hayes, 541 So. 2d 1023, 1026 (Miss. 1989); State Highway Comm'n v. Culpepper, 536 So. 2d 18, 19 (Miss. 1988).

[31] Paulk v. Housing Authority of City of Tupelo, 228 So. 2d 871, 873 (Miss. 1969). The court explained that it had previously upheld the Housing Authority's right to condemn Paulk's property, and thus the issues before the court involved discovery matters. *Paulk*, 228 So. 2d at 873-74.

[32] *Id.* at 873. The Housing Authority answered some of the interrogatories but petitioned the trial court to suppress the interrogatories relating to their expert appraisers and their valuations. *Id.*

[33] *Id.* "The trial court has considerable discretion in matters pertaining to discovery, and its exercise of discretion will not be set aside in the absence of an abuse of that discretion, which did not occur here." In fact, this rule of deferring to the trial court is the sole reason *Paulk* has subsequently been cited. *See* Clark v. Mississippi Power Co., 372 So. 2d 1077, 1080 (Miss. 1979); Harkins v. Paschall, 348 So. 2d 1019, 1022 (Miss. 1977).

[34] *Paulk*, 228 So. 2d at 873. Since there had been two prior trials of this condemnation action, the court reasoned that Paulk had ample opportunity for discovery, including discovery about the Housing Authority's expert appraisers. *Id.*

to the *Paulk* standard. In fact, the Mississippi Rules of Civil Procedure which pertain to the discovery of experts' opinions supersede the proposition advanced in *Paulk*.[35]

III. PURPOSES OF PRETRIAL DISCOVERY IN EMINENT DOMAIN PROCEEDINGS IN OTHER JURISDICTIONS

Since the government's eminent domain powers proceed from the federal and state Constitutions, a landowner is entitled to receive just compensation.[36] To effectuate this purpose, pretrial discovery rules in eminent domain proceedings should be liberally construed.[37] Permitting discovery of an expert's appraisal report can provide many benefits to the landowner and to the courts.[38] Furthermore, the complex and technical procedures involved in evaluating land can be explained by the expert's testimony and appraisal report.[39] Because of the importance of the expert appraiser's testimony, some jurisdictions require mandatory disclosure of the appraisal reports.[40]

For example, California, New York, and Texas statutorily require disclosure of information relating to expert appraisers in eminent domain proceedings. In California, a party may demand an exchange of valuation data prepared by their opposing party's experts.[41] In New York, court rules provide that appraisal reports shall be exchanged no later than nine months after service of the condemnation claim.[42] In Texas, both the condemnor and the condemnee must exchange all existing appraisal reports either has produced or acquired in relation to the subject property.[43]

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[35] *See* MISS. R. CIV. P. 26(b)(4). *See also* Morley v. Jackson Redevelopment Auth., 632 So. 2d 1284, 1291-93 (Miss. 1994) (explaining when condemnor's expert may be called as witness by condemnee).

[36] *See* U.S. CONST. amend. V; MISS. CONST. art. III, § 17.

[37] M. Jay Devaney, *Discovery of the Valuation Expert in Condemnation Proceedings*, 20 REAL PROP. PROB. & TR. J. 1093, 1096 (1985).

[38] Devaney, *supra* note 37, at 1093. The author lists the benefits as determining what is due compensation, encouraging settlements, and aiding in preparation for trial. *Id.*

[39] Devaney, *supra* note 37, at 1097-98. Expert appraisers, in fact, are the most important witnesses in a condemnation trial, which "consists primarily of the submission of the opinions of the expert appraisers, the factual and theoretical bases upon which they rest, and the testing of those opinions through cross-examination and rebuttal." Connie C. Sandifer & Timothy J. Chang, *The Advantageous Use of Discovery in Eminent Domain*, SB48 ALI-ABA 183, 190 (1997). Furthermore, in order for opposing counsel to prepare effectively for cross-examination, full pretrial disclosure is necessary. Devaney, *supra* note 37, at 1094-95.

[40] Sandifer, *supra* note 39, at 189 (listing six states which mandate exchange of appraisal reports). *See also* UNIF. EMINENT DOMAIN CODE § 702 (1974) (permitting parties to request production of appraisal reports without prior showing of need for information).

Some state rules do not require that the appraisal reports be exchanged but rather qualify that the information contained therein may be discovered. In New Jersey, the condemnor must provide reasonable disclosures of how a condemnation award was calculated.[44] In Maryland, a party, through interrogatories, may request production of any written report made by an expert expected to be called at trial.[45] Alabama, however, expressly forbids the exchange of appraisal reports in eminent domain proceedings.[46]

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[41] CAL. CIV. PROC. § 1258.210 (West 1998). The comment to section 1258.210 clarifies that the exchange of valuation information is not mandatory but rather only upon request by a party. Comment, CAL. CIV. PROC. § 1258.210.

[42] N.Y. CT. RULES § 202.61 (McKinney 1997). *See also* Gerhart v. Honeoye Storage Corp., 451 N.Y.S.2d 481, 482 (N.Y. App. Div. 1982) (explaining New York trial court rules require parties to exchange appraisal reports).

[43] TEX. PROP. CODE ANN. § 21.0111 (West 1995). In Texas, the following information must be disclosed:

> (a) A governmental entity with eminent domain authority that wants to acquire real property for a public use shall disclose to the property owner at the time an offer to purchase is made any and all existing appraisal reports produced or acquired by the governmental entity relating specifically to the owner's property and used in determining the final valuation offer.
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> (b) A property owner shall disclose to the acquiring governmental entity any and all existing appraisal reports produced or acquired by the property owner relating specifically to the owner's property and used in determining the owner's opinion of value. . . .

Id. Prior to adopting this statute, the Texas Supreme Court held that a landowner must show "good cause" in order to obtain the government's appraisal report. *Ex parte* Shepperd, 513 S.W.2d 813, 815-16 (Tex. 1974).

[44] N.J. STAT. ANN. § 20:3-6 (West 1997) (requiring condemnor to make compensation offer in writing to condemnee and include reasonable disclosure of how offer was calculated). *See also* New Jersey v. Town of Morristown, 609 A.2d 409, 413-14 (N.J. 1992) (interpreting § 20:3-6 as impliedly requiring condemnor to disclose to condemnee appraisal reports used in calculating compensation offer). Court rules require parties to exchange appraisal reports of those experts who will testify at least fifteen days prior to a hearing. N.J. CT. R. 4:73-11 (West 1997).

When the scope of discovery has not been outlined by statute, courts have intervened to resolve discovery disputes in condemnation actions. In 1968, the Ninth Circuit took the lead in fashioning liberal discovery rules in eminent domain proceedings in *United States v. Meyer*.[47] When the federal government condemned private property held within Yosemite National Park, the landowner deposed the government's real estate appraisers and requested them to produce their appraisal reports.[48] At the deposition, the appraisers refused to answer questions relating to their appraisals and did not produce their reports.[49] The Court of Appeals for the Ninth Circuit held that the experts should have answered the deposition questions and should have produced their reports.[50] The *Meyer* court explained the importance of expert testimony in eminent domain proceedings:

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[45] MD. R. CIV. P. 3-421(a)(3) (Michie 1997). *See also* IOWA R. CIV. P. 125(a)(2) (West 1998) (providing discovery of reports prepared by expert in anticipation of litigation); *cf.* IND. CODE ANN. § 32-11-6-1 (Michie 1995) (requiring disclosure of court-appointed appraiser's report).

[46] ALA. CODE § 18-1A-130 (1997). *See also In re* Bragg, No. CV-97-71, 1998 WL 57737, at *1, *3 (Ala. Feb. 13, 1998) (holding that trial court judge abused his discretion in ordering appraisal reports to be produced and thus violated express statutory prohibition against such discovery); *cf.* CONN. GEN. STAT. ANN. § 1-19 (West 1988) (exempting from disclosure real estate appraisal reports made for or by state agency).

[47] United States v. Meyer, 398 F.2d 66 (9th Cir. 1968). *See also* Alaska v. Leach, 516 P.2d 1383, 1384-85 (Alaska 1973) (allowing liberal discovery of expert appraisal reports due to unique character of condemnation proceedings).

The Court of Appeals for the Fifth Circuit, however, has not followed the Ninth Circuit's lead. In *Hoover v. United States Dep't of the Interior*, the court prohibited the discovery of an outside appraiser's report when the landowner filed suit under the Freedom of Information Act. Hoover v. United States Dep't of the Interior, 611 F.2d 1132, 1142 (5th Cir. 1980). The *Hoover* court found the *Meyer* decision unpersuasive and stated that the "essence of the decision in *Meyer* is not that appraisals per se are discoverable, but that landowners should be able to discover the opinions and views of the appraisers in order to prepare for effective cross-examination." *Hoover*, 611 F.2d at 1140.

Courts have responded to the *Hoover* and *Meyer* dichotomy. The federal court of the Northern District of California, for example, claimed that the issue in *Hoover* was "not whether the appraisal report was discoverable in a condemnation proceeding, but instead, whether the owner of the property could compel the Department of the Interior to make public the report by filing suit under the Freedom of Information Act. . . . " United States v. 22.80 Acres of Land, 107 F.R.D. 20, 23 (N.D. Cal. 1985).

[48] *Meyer*, 398 F.2d at 68. The federal government moved for an order to pro-

> The appraisers' opinions and their factual and theoretical foundation are peculiarly within the knowledge of each appraiser and, to a degree, that of the party who employed him. The opposing party can obtain this information in advance of trial only by discovery. Since this material will constitute the substance of the trial, pretrial disclosure is necessary if the parties are to fairly evaluate their respective claims for settlement purposes, determine the real areas of dispute, narrow the actual issues, avoid surprise, and prepare adequately for cross-examination and rebuttal.[51]

Other courts have addressed the importance of pretrial discovery of expert appraisers' opinions. In *Shell v. State Road Department*, the Supreme Court of Florida held that the government must produce its appraiser's work sheets.[52] The court acknowledged the unique circumstances in condemnation proceedings, mainly the government's unlimited resources, and reasoned that pretrial disclosure would not be unfair to the government.[53] In *Crist v. Iowa State Highway Commission*,

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tect the appraisal reports. *Id.*

[49] *Id.*

[50] *Id.* at 69.

[51] *Id.* The *Meyer* court thus ordered full disclosure of the appraisers' opinions and the basis thereof so that the parties could prepare for trial. *Id.* at 70. ***But see*** Perras v. Clements, 503 A.2d 843, 845 (N.H. 1986) (denying motion to disclose appraisal report on basis that appraisals are confidential but suggesting that landowner pursue other means of discovery to obtain information contained in appraisal reports).

[52] Shell v. State Rd. Dep't, 135 So. 2d 857, 861 (Fla. 1961). The landowner had requested that the government produce all documents relating to the valuation of his land, including the appraiser's work. *Shell*, 135 So. 2d at 858.

[53] *Id.* at 861. The *Shell* court explained that the landowner being subject to condemnation without his consent contributes to the special circumstances present in eminent domain cases. *Id.*

the Supreme Court of Iowa concluded that the government's appraiser could be deposed and asked about his appraisal report.[54]

IV. THE DEBATE: SHOULD EXPERTS' APPRAISAL REPORTS BE DISCOVERABLE?

Outside the context of eminent domain, whether expert reports are discoverable revolves around a jurisdiction's interpretation of civil discovery rules. The federal district court in the Northern District of Mississippi in *Breedlove v. Beech Aircraft Corp.*,[55] for example, held that the disclosure of expert documents may not be required unless the party requesting production shows unique or exceptional circumstances.[56] The party resisting discovery argued that the reports were not discoverable under the attorney-client privilege and the work product doctrine.[57] Regarding the attorney-client privilege, the court denied discovery on the theory that the party requesting discovery failed to show "unique or exceptional circumstances making it equitable to require the production of expert reports. . . . "[58] Regarding the work product doctrine, the court concluded that the reports on the defective products were prepared in anticipation of litigation and thus were not discoverable.[59] The court stated "there has been no showing of any special circumstances demonstrating an undue hardship on plaintiffs for obtaining the substantive equivalent of the materials by other means."[60]

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[54] Crist v. Iowa State Highway Comm'n, 123 N.W.2d 424, 431 (Iowa 1963). In *Crist*, the landowners submitted various interrogatories to the government relating to the experts employed and their appraisal reports. *Crist*, 123 N.W.2d at 428. The court permitted this means of discovering the opinions held by those experts who were to be called at trial. *Id.* at 431.

See also Utah Dep't of Transp. v. Rayco Corp., 599 P.2d 481, 490-91 (Utah 1979) (holding that expert's appraisal report must be produced when landowner cross-examines appraiser at trial); *cf.* United States v. John R.-Piquette Corp., 52 F.R.D. 370, 372 (E.D. Mich. 1971) (urging parties to pursue discovery of expert opinions through interrogatories before pursuing other means of discovery); Wilson v. Resnick, 51 F.R.D. 510, 511 (E.D. Pa. 1970) (holding in medical malpractice action that discovery of expert reports should be through interrogatories and not through production).

[55] Breedlove v. Beech Aircraft Corp., 57 F.R.D. 202 (N.D. Miss. 1972). In *Breedlove*, the plaintiff, a victim in an airplane crash, sought discovery of reports written by the plane manufacturer, Beech Aircraft Corporation. *Breedlove*, 57 F.R.D. at 204.

[56] *Id.* at 205. *See also* United States v. 145.31 Acres of Land, 54 F.R.D. 359, 360 (M.D. Pa. 1972) (holding that party seeking production of expert appraisal reports must show compelling need), *aff'd*, 485 F.2d 682 (3d Cir. 1973). *But see* Quadrini v. Sikorsky Aircraft Div., 74 F.R.D. 594, 595 (D. Conn. 1977) (granting motion to compel production of experts' reports in helicopter crash and holding that preparation for trial and cross-examination met substantial need requirement).

[57] *Breedlove*, 57 F.R.D. at 204. In a patent litigation case, the patent holder argued against discovery of its expert's reports using the work product doctrine.

Some courts refuse to apply these privileges in the eminent domain context however. First, the attorney-client privilege

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Hewlett-Packard Co. v. Bausch & Lomb, Inc., 116 F.R.D. 533, 536 (N.D. Cal. 1987). The court determined that documents drawn by experts do not fit within Rule 26's "work product" definition. *Hewlett-Packard Co.*, 116 F.R.D. at 536. Furthermore, the court acknowledged that disclosure of expert's documents aids the opposing party in cross-examining the expert. *Id.* at 537.

[58] *Breedlove*, 57 F.R.D. at 205.

[59] *Id.* Under Rule 26(b)(3) of the Mississippi Rules of Civil Procedure, materials that are prepared in anticipation of litigation are not discoverable unless the party seeking discovery demonstrates substantial need for the materials. MISS. R. CIV. P. 26(b)(3). If the party seeking discovery meets this burden, the court "shall protect against disclosure of the mental impressions, conclusions, opinions, or legal theories of an attorney or other representative of a party concerning the litigation." *Id.*

In *Haynes v. Anderson*, the Mississippi Supreme Court discussed the scope of the work product doctrine in the context of an insurance adjuster's investigative file. Haynes v. Anderson, 597 So. 2d 615 (Miss. 1992). Haynes and Anderson were in an accident, and Haynes reported the accident to his insurer, State Farm, who began to investigate the claim. *Haynes*, 597 So. 2d at 616. When Anderson sought discovery of State Farm's investigative file, Haynes argued that it was protected from disclosure because it was prepared in anticipation of litigation. *Id.* at 617. The court remanded the case to decide if the investigative file was work product in light of the test the court announced. *Id.* at 619. The court adopted a case-by-case test based on the facts to determine when the work product doctrine protects materials. *Id.* at 618-19.

[60] *Breedlove*, 57 F.R.D. at 205. Courts have also used the work product doctrine as a justification for denying discovery of expert's reports when the expert acts as an agent for the attorney. Note, *Discovery of Expert Opinion in Land Condemnation Proceedings*, 41 IND. L.J. 506, 508 (1966). *But see* Department of Transp. v. Western Nat'l Bank, 347 N.E.2d 161, 166 (Ill. 1976) (rejecting government's argument that expert appraisal reports were protected under work product doctrine and stating that such reports are discoverable as "statements by third parties who have knowledge of the facts involved in the controversy").

was designed to protect communications between an attorney and his client.[61] Some courts reason that experts relay messages from clients to attorneys, like assistant counsel, and as such should be protected by the attorney-client privilege.[62] The majority of courts, however, do not apply the attorney-client privilege to eminent domain experts who merely appraise property and reduce their findings to writing.[63] Expert real estate appraisers, moreover, are not classified as clients when it is the government who is condemning property.[64] Second, some courts protect expert appraisal reports from discovery under the work product doctrine.[65] However, some courts theorize that expert appraisal reports are prepared in the ordinary course of business for the purpose of negotiating a fair price for the condemned property and thus fulfill purposes which are independent of litigation objectives.[66] In fact, the majority of courts hold that the work product doctrine does not protect experts' documents.[67]

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[61] L. Richard Fischer, *Discovery of Expert Opinions and Conclusions in Condemnation Proceedings in Federal and California Courts*, 20 HASTINGS L.J. 650, 658 (1969). Commentators have noted that this privilege was designed to protect from disclosure communications between an attorney and his client but has been extended in some jurisdictions to protect communications between the attorney and a client's expert, who acts as the client's agent. *Condemnation in Indiana: Discovery of Expert Appraisal Reports*, *supra* note 5, at 434.

[62] *Condemnation in Indiana: Discovery of Expert Appraisal Reports*, *supra* note 5, at 434. *See also Discovery of Expert Opinion in Land Condemnation Proceedings*, *supra* note 60, at 507 (noting that some courts view attorney, expert, and client as "team" making all three protected by attorney-client privilege).

[63] *Condemnation in Indiana: Discovery of Expert Appraisal Reports*, *supra* note 5, at 434-35.

[64] United States v. Meyer, 398 F.2d 66, 74 (9th Cir. 1968). *See also* Fischer, *supra* note 61, at 658 (noting that "[t]rend in federal courts is now toward the exclusion of the expert from the protection of the attorney-client privilege").

[65] *See Condemnation in Indiana: Discovery of Expert Appraisal Reports*, *supra* note 5, at 437 (noting that theory of expert acting as agent for attorney has been applied to work product doctrine as well); *see also* Hickman v. Taylor, 329 U.S. 495, 509 (1947) (stating that work product doctrine protects mental impressions of attorney from discovery).

[66] United States v. 22.80 Acres of Land, 107 F.R.D. 20, 24-25 (N.D. Cal. 1985). *See also Meyer*, 398 F.2d at 74 (holding that expert opinions do not become work product of attorneys simply because experts communicate their opinions in appraisal reports).

[67] Lee Mickus, *Discovery of Work Product Disclosed to a Testifying Expert*

In addition to arguments of privilege, some courts will not compel production of expert appraisal reports out of fear that it will result in confusion and unfairness. As for confusion, pretrial disclosure of complex valuation methods may make the trial process less efficient.[68] As for unfairness, some courts rationalize that permitting the landowner to use the government's expert's report without paying for it is fundamentally unfair.[69] If the court were to permit discovery of this sort, it would be tantamount to "taking of the opponent's property without just compensation."[70]

Under the 1993 Amendments to the Federal Rules of Civil Procedure, 27 CREIGHTON L. REV. 773, 784-85 (1994) (stating that "bulk of the authority recognizes that the work product doctrine does not protect documents generated by experts who are expected to testify").

[68] *See* United States v. Certain Acres of Land, 18 F.R.D. 98 (M.D. Ga. 1955). In *United States v. Certain Acres of Land*, the landowners filed a motion to inspect and copy the government's expert's appraisal reports. *Certain Acres of Land*, 18 F.R.D. at 98. The court denied the landowners' request and reasoned that pretrial discovery would result in confusion and would slow down the judicial system. *Id.* at 100.

Likewise, in *United States v. 6.82 Acres of Land*, the landowners sought to depose the government's real estate appraisers. United States v. 6.82 Acres of Land, 18 F.R.D. 195, 196 (D.N.M. 1955). The court concluded that the government did not have to disclose any matters pertaining to their evaluation experts since disclosure would cause confusion. *6.82 Acres of Land*, 18 F.R.D. at 197.

[69] *See* United States v. 900.57 Acres of Land, 30 F.R.D. 512, 519-21 (W.D. Ark. 1962) (holding that landowners could not obtain copy of expert's appraisal report since information contained therein was otherwise obtainable and since production would prolong trial); *6.82 Acres of Land*, 18 F.R.D. at 197 (quashing subpoena to produce expert's appraisal report on basis that information was obvious to landowners). *But see* United States v. 23.76 Acres of Land, 32 F.R.D. 593, 597 (D. Md. 1963) ("[w]here value is the basic, if not sole, issue in litigation, it is not unfair for either party to know in advance of trial what the other party intends to prove, what opinions his opponent's experts hold, the method by which those opinions were formulated, and the facts upon which they are based.").

[70] Fischer, *supra* note 61, at 659. One court proposed a solution to this fundamental unfairness by requiring the landowner to pay the government's expert's fees when the landowner deposed the government's expert. State v. Grudnik, 243 N.W.2d 796, 798-99 (S.D. 1976).

Compelling disclosure of the expert appraisal report may be deemed unfair for the reason that the information is obvious to the landowner and that the landowner can simply hire an independent appraiser to write a report. Hornback v. State Highway Comm'r, 135 S.E.2d 136, 138-39 (Va. 1964).

V. CONCLUSION

If the Mississippi Supreme Court is asked to resolve the issue of whether an appraisal report prepared by the condemning authority's expert is discoverable by the landowner, the court should permit liberal discovery. The landowner would otherwise be unable to obtain the evidence contained in the appraisal report. The appraisal report is not protected by the attorney-client privilege since the expert is not a client of the condemnor's attorney. Nor is the appraisal report protected under the work product doctrine since appraisal reports are routinely prepared prior to the taking and not in anticipation of litigation. In sum, the landowner should have access to the condemnor's expert's appraisal report so that the landowner can prepare effectively for trial.

Mandee Broussard Baumer

BINDING SHAREHOLDER BYLAW AMENDMENTS: AN ANTIDOTE FOR THE POISON PILL?[*]

I. INTRODUCTION: THE CRUCIAL ROLE OF THE POISON PILL IN THE TAKEOVER MARKET

The shareholder rights plan, or poison pill, has transformed the rules of the takeover market. Invented in the mid-1980s, the poison pill takes the form of either a distribution of preferred shares or common stock option rights to all shareholders.[1] When a hostile third-party acquiror announces a tender offer for the target issuer or accumulates a designated percentage of the target issuer's outstanding shares (usually 10% or 15%), the preferred shares or option rights trigger (the "flip-in"), giving all shareholders other than the acquiror the right to acquire the target issuer's common stock at half the market price.[2] Alternatively, if the third-party acquiror attempts to merge with the target issuer or acquire its assets, the preferred shares or option rights trigger (the "flip-over" or "flip-out") and become the right to acquire common stock of the third-party acquiror at half the market price.[3] Regardless of the action that triggers it, the poison pill is intended to make the hostile acquisition prohibitively expensive by diluting the acquiror's ownership.[4]

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[*] Special thanks to Professor Bryn Vaaler for his invaluable insight and guidance in the development of this comment.

[1] *See* ROBERT W. HAMILTON, FUNDAMENTALS OF MODERN BUSINESS 403 (1989).

[2] *See* HAROLD S. BLOOMENTHAL, SECURITIES AND FEDERAL CORPORATE LAW § 13.35 (3d ed. 1997).

[3] *Id.*

[4] *See* PAUL W. RICHTER, CORPORATE ANTI-TAKEOVER DEFENSES: THE POISON PILL DEVICE at xvi (1987); *see also* Geoffrey Miller, *Political Structure and Corporate Governance: Some Points of Contrast Between the United States and England*, 1998 COLUM. BUS. L. REV. 52, 55-56 (1998) (noting role of poison pill in United

The key feature of the poison pill is that a corporation's board of directors can put it in place by unilateral action (i.e., without the need for shareholder approval), and the board retains the right to redeem the pill for a nominal amount after it triggers.[5] This places the board in a "gatekeeper" role with respect to a hostile acquisition, even where the potential acquiror makes a direct appeal to shareholders. The board's ability to reinsert itself between hostile acquirors and shareholders through a poison pill has been a highly controversial development in corporate governance.[6]

The board's mechanical ability to adopt and maintain pills was approved under the Delaware corporate statute in *Moran v. Household International, Inc.* in 1985.[7] Since then, the poison pill has prevailed as the anti-takeover device of choice of public corporations.[8] While the Delaware Supreme Court ap-

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States' takeover law).

[5] HAMILTON, *supra* note 1.

[6] *See* Morgan N. Neuwirth, Comment, *Shareholder Franchise — No Compromise: Why the Delaware Courts Must Proscribe All Managerial Interference with Corporate Voting*, 145 U. PA. L. REV. 423, 484 (1996) (arguing proxy fight is aggressor's only viable method of taking control); *see also* Jeffrey N. Gordon, *"Just Say Never?" Poison Pills, Deadhand Pills, and Shareholder-Adopted Bylaws: An Essay for Warren Buffet*, 19 CARDOZO L. REV. 511, 512 (1997) (noting use of poison pill not only affects aggressor's post-bid strategy, but affects decision whether to bid at all). This positioning of the board as corporate "guardians" has led some scholars to ask "who will guard the guardians." *See* Joseph A. Grundfest, *Just Vote No: A Minimalist Strategy for Dealing with Barbarians Inside the Gates*, 45 STAN. L. REV. 857, 862-65 (1993).

[7] *See* Moran v. Household Int'l, Inc., 500 A.2d 1346 (Del. 1985); *see also* Meredith M. Brown & William D. Regner, *Shareholder Rights Plans: Recent Toxopharmocological Developments*, 11 NO. 10 INSIGHTS 2, 2 (1997) (sketching history of poison pill litigation); Robert A. Helman & James J. Junewicz, *A Fresh Look at Poison Pills*, 42 BUS. LAW. 771, 771 (1987) (noting corporate rush to adopt pill plans after *Moran* decision). Courts in other key corporate states have also approved the mechanical feasibility of the pill under their corporate statutes. *See infra* note 14 and accompanying text. Where mechanical problems were noted, state legislatures have acted to adopt legislation aimed at correcting difficulties and specifically authorizing poison pills. *See infra* note 19 and accompanying text.

[8] More than half of U.S. public companies — over 1,800 — currently have poison pills. *See* Joann S. Lublin, *"Poison Pills" Are Giving Shareholders a Big Headache, Union Proposals Assert*, WALL ST. J., May 23, 1997, at C1; *see also* Dennis J. Block et al., *Current Trends in the Market for Corporate Control*, 972

proved the pill as a mechanical matter in *Moran*, it indicated that the board would be judged by the enhanced scrutiny standard articulated in *Unocal Corp. v. Mesa Petroleum Co.* to determine whether implementation or retention of a pill comported with the board's fiduciary duties.[9] Under the *Unocal* test, the board must prove that it deployed a defensive mechanism, such as a pill, in response to a reasonably perceived threat to the corporation or its shareholders, and that it was a proportionate response to that threat.[10]

The pill's effectiveness has made it a focal point in the continuing debate over the proper role of the board of directors and of shareholders in the corporate governance surrounding a takeover.[11] Proponents point to empirical evidence which in-

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P.L.I. 7, 83 (1997) (noting that smaller firms are installing pills as cautionary measure).

[9] Prior to *Unocal*, Delaware courts applied the business judgment rule to takeover defenses. *See* Elizabeth M. McGeever, *Scrutinizing Hostile Takeover Defenses*, SB93 A.L.I.-A.B.A. 503, 505 (1997).

[10] Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 946, 954-55 (Del. 1985). The *Unocal* court itself stated that enhanced judicial scrutiny is necessary to combat the "omnipresent specter that a board may be acting primarily in its own interests." *Unocal*, 493 A.2d at 954.

The pill has been generally upheld as a "proportionate response" because it does not preclude tender offers or impede proxy contests. *See Moran*, 500 A.2d at 1357; *see also* Blasius Indus. v. Atlas Corp., 564 A.2d 651, 661 (Del. Ch. 1988) (applying "compelling justification" test to board actions taken primarily to prevent shareholder voting); FOLK ON THE DELAWARE GENERAL CORPORATION LAW: FUNDAMENTALS § 141.2.4, at 114-46 (1996) (discussing responses to takeover threats).

[11] The creator of the poison pill, Marty Lipton, has argued that the "managerial discipline model," which focuses on following shareholder wishes and fostering hostile takeovers, is counterproductive to "long-term business success." Martin Lipton & Steven A. Rosenblum, *A New System of Corporate Governance: The Quinquennial Election of Directors*, 58 U. CHI. L. REV. 187, 189 (1991). *See generally* John Pound, *The Rise of the Political Model of Corporate Governance and Corporate Control*, 68 N.Y.U. L. REV. 1003 (1993) (contrasting "political model" with 1980's "market-based model"). Others have argued that the pill's enhancement of board power critically reduces accountability. *See e.g.*, Mark J. Loewenstein, *The SEC and the Future of Corporate Governance*, 45 ALA. L. REV. 783, 790-91 (1994) (analyzing "absolute delegation rule" in corporate law).

The crux of the governance problem is finding a "balance between maximizing the efficiencies necessary to create wealth and ensuring that the controlling parties are accountable to those with a stake in the enterprise." Carol B.

dicates that the pill is essential to protect the corporation and shareholders from takeover offers that do not reflect the full value of the business.[12] They argue that Delaware's *Unocal* regime protects shareholders from abusive use of the pill by corporate boards, and in fact, enables boards to negotiate a better price for shareholders.[13] Proponents also point to state

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Swanson, *Corporate Governance: Sliding Seamlessly into the Twenty-First Century*, 21 J. CORP. L. 417, 419 (1996). *See* James P. Holdcroft, Jr. & Jonathan R. Macey, *Flexibility in Determining the Role of the Board of Directors in the Age of Information*, 19 CARDOZO L. REV. 291, 292 (1997) (proposing more active shareholder role in corporate governance). The traditional view of shareholders as the "owners" of the corporation and directors as their elected agents persists, but has been criticized as "an old-fashioned legal fiction." *See* Roberta S. Karmel, *Implications of the Stakeholder Model*, 61 GEO. WASH. L. REV. 1156, 1156 (1993).

For an evaluation of the prevailing theories of corporate law, and proposals for the future of the public corporation, see generally PROGRESSIVE CORPORATE LAW (Lawrence E. Mitchell ed., Westview Press 1995).

[12] There is convincing evidence that poison pills enhance shareholder value. *See* Jamil Aboumeri, *Poison Pills and Shareholder Value/1992-96*, 68 CORP. (Aspen Law & Bus.) ¶ 24.1, at 5 (Dec. 15, 1997). A recently completed study by Georgeson & Company found that between 1992 and 1996, target companies with pills received 26% higher premiums than other companies, resulting in $13 billion in added shareholder value. *Id.* at 2-3. In addition, merger and acquisition activity has recently surged. *See* Miriam P. Hechler, *Towards a More Balanced Treatment of Bidder and Target Shareholders*, COLUM. BUS. L. REV. 319, 320-22 (1997) (discussing "comeback of mergers and acquisitions"). *See also* Martin Lipton, *Merger and Acquisition Activity Continued at a Record Pace in 1997: What Were the Contributing Factors?*, N.Y.L.J., Feb. 2, 1998, at 7 (stating that merger activity of past three years has continued at "record-breaking pace," with 10,700 announced U.S. mergers in 1997); Swanson, *supra* note 11, at 419 (stating that takeovers "have resurged with a vengeance"); Chuck Evans, *From Revco to MedPartners, PR Executive Has Ridden a Wave of Corporate Buyouts*, BIRMINGHAM BUS. J., Dec. 8, 1997, at 11 (chronicling series of corporate takeovers).

The Georgeson study found that companies with poison pills were not more likely to avoid being targeted or to defeat a bidder. Aboumeri, *supra*, at 4. However, other data has shown that between 1994 and October, 1997, hostile bidders' success rate was just over one-third. *See* Steven Lipin, Heard on the Street, *Raiders of a Lost Art: Hostile Bidders Fail More Often*, WALL ST. J. Nov. 14, 1997, at C1 (discussing study by J.P. Morgan). This is significantly lower than the 42% bidder success rate between 1988 and 1993. *Id.* at C2.

[13] Historically, the poison pill has given corporate boards the leverage needed to protect shareholders from "low ball," coercive or otherwise unsatisfactory bids. The legendary example from the hostile raider heyday is T. Boone Pickens' two-tiered, front-end loaded tender offer, which inspired the litigation that resulted in Delaware's *Unocal* decision, the premier case regarding judicial review of takeover

legislation which specifically authorizes use of the pill and other anti-takeover measures.[14]

Opponents argue that the *Unocal* test has not protected shareholders.[15] While the pill gives the board the ability to

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defenses. *See* Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 946 (Del. 1985).

[14] *See e.g.*, N.Y. BUS. CORP. LAW § 505(a)(2)(i) (McKinney 1997 Supp.) (specifically authorizing poison pill defense); *see generally* Neil Fabricant, *Hostile Tender Offers: Can the States Shut Them Down?*, 22 J. CORP. L. 27 (1996) (analyzing impact of state anti-takeover laws on hostile bidders); David N. Hecht, *The Little Train that Couldn't: Did the Pennsylvania Anti-Takeover Statute Fail to Protect Conrail from a Hostile Suitor?*, 66 FORDHAM L. REV. 931, 934-43 (1997) (discussing evolution of anti-takeover statutes); Daniel A. Neff, *The Impact of State Statutes and Continuing Director Rights Plans*, 51 U. MIAMI L. REV. 663 (1997) (discussing various state anti-takeover provisions); Dale A. Oesterle, *Revisiting the Anti-takeover Fervor of the '80's Through the Letters of Warren Buffett: Current Acquisition Practice Is Clogged By Legal Flotsam from the Decade*, 19 CARDOZO L. REV. 565 (1997) (chronicling anti-takeover movement). These statutes have proven resistant to constitutional challenge, *see e.g.*, CTS Corp. v. Dynamics Corp. of Am., 481 U.S. 69 (1987) (upholding Indiana's "Control Share Acquisitions" law), but have not been without criticism. In upholding Wisconsin's anti-takeover law, the Seventh Circuit stated that such statutes hurt shareholders. Amanda Acquisition Corp. v. Universal Foods Corp., 877 F.2d 496, 500 (7th Cir. 1989).

[15] *See* Park McGinty, *The Twilight of Fiduciary Duties: On the Need for Shareholder Self-Help in an Age of Formalistic Proceduralism*, 46 EMORY L.J. 163, 278 (1997) (stating "Unocal is dead"). As an example, opponents cite Time, Inc.'s successful effort to "preserve Time culture" by fending off Paramount Communications' $200 per share bid and merging with Warner Communications. *See* Paramount Communications, Inc. v. Time, Inc., 571 A.2d 1140, 1150 (Del. 1989) (upholding Time's defenses). Subsequent data showed that the board's choice to forego the Paramount offer resulted in a $6.2 billion loss in value to shareholders. *See* McGinty, *supra*, at 301 (noting *Forbes*' conclusion that based on Time-Warner's stock price three years after the deal, shareholders would have realized two and one half times that price had Time accepted Paramount's offer); *see also* JAMES D. COX ET AL., CORPORATIONS § 23.26 (1995) (stating that *Paramount* "reaffirms" that board's judgment regarding "long term benefits" of its plan is "presumptively infallible").

The Delaware Supreme Court later modified the proportionality prong of the *Unocal* test. *See* Unitrin, Inc. v. American Gen. Corp. (*In re* Unitrin, Inc.), 651 A.2d 1361 (Del. 1995). Under *Unitrin*, as long as a corporate defense does not present a "draconian" preclusion of shareholder choice, it must only fall within the "range of reasonableness." *In re* Unitrin, 651 A.2d at 1387-88. *See* Gregory W. Werkheiser, Comment, *Defending the Corporate Bastion: Proportionality and the Treatment of Draconian Defenses From Unocal to Unitrin*, 21 DEL. J. CORP. L. 103, 104 (1996). Critics of this development suggest that noncoercive, fully financed takeover offers should be distinguished from the coercive, over-leveraged bids the pill was designed to combat. *See* Fabricant, *supra* note 14, at 50; *see* negotiate price, it also gives them the ability to "just say no" to offers that the vast majority of shareholders would be delighted to accept. The extreme case was *Moore v. Wallace Computer Services,*[16] where the United States District Court for the District of Delaware upheld Wallace Computer Service's pill defense even though almost 75% of its shareholders had tendered their shares to Moore Corporation.[17] Furthermore, not all courts are going to follow the enhanced scrutiny of the *Unocal* test.[18] In addition, the shareholders' ability to vote the board out of office has been blunted by board use of the pill in combination with staggered elections for board members and by the renaissance of the "deadhand" pill.[19]

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also McGeever, *supra* note 9, at 506 (noting today's "hostile bidders" are backing searches for "strategic fits" with substantial cash premiums). They argue that the threat of hostile takeovers has diminished to the point that shareholders cannot rely on the market to correct or dislodge faltering management. *See* Grundfest, *supra* note 6, at 862. In addition to the pill, most corporate boards have a stunning array of defenses at their disposal. For a summary of these defenses, see Neuwirth, *supra* note 6, at 437-43.

[16] *See* Moore Corp. v. Wallace Computer Services, Inc., 907 F. Supp. 1545, 1583 (D. Del. 1995).

[17] *See* Meredith M. Brown & William D. Regner, *'Just Say No' Revisited:* Moore v. Wallace Computer Services, 68 CORP. (Aspen Law & Bus.) 2, March 15, 1996, ¶6.1; *see also* Daniel A. Dreisbach & Catherine G. Wagner, *The Right of the Target's Board to 'Just Say No' in Delaware*, 10 NO. 3 INSIGHTS 25 (1996) (discussing *Moore*); Victor L. Lewkow & William A. Groll, *"Poison Pills" and Other Structural Defenses: Uses and Abuses in the Age of Saying "No,"* 731 P.L.I./CORP. 417 (1991) (discussing "just say no" defense).

[18] *See e.g.*, Dynamics Corp. of Am. v. WHX Corp., 967 F. Supp. 59, 64 (D. Conn. 1997) (applying business judgment rule under New York law to board's refusal to redeem poison pill).

[19] *See* Invacare Corp. v. Healthdyne Techs., Inc., 968 F. Supp. 1578, 1582 (N.D. Ga. 1997) (upholding "dead hand" poison pill under Georgia law); *but see* Bank of New York Co. v. Irving Bank Corp., 528 N.Y.S.2d 482, 485 (N.Y. Sup. Ct. 1988) (holding dead hand pill illegally impinged on board's power to manage company under New York law). A Delaware court recently held that a class-action suit challenging a company's dead hand provision stated "legally cognizable claims" under Delaware law, and denied the company's motion to dismiss it. Carmody v. Toll Bros., Inc., C.A. No. 15983, 1998 WL 418896, at *1 (Del. Ch. July 24, 1998). A final ruling will have a significant impact on the emerging popularity of dead hand pills. *See* Steven Lipin, *Delaware Court Finds New Poison-Pill Is Coercive, Stripping Holders' Rights*, WALL ST. J., July 27, 1998, at B2 (discussing implications of Delaware ruling); *see also* Sara-Ellen Amster, *"Dead-*

The debate over poison pills has fostered an increase in shareholder activism, due primarily to the emergence of large institutional investors willing to exercise their clout.[20] Poison

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hand" Pill Questioned, WILMINGTON NEWS-J., July 27, 1998, *available in* 1998 WL 5631439 (stating that legality of dead hand provision "is now in question").

In its effort to acquire Healthdyne Technologies, Inc. (Healthdyne), a Georgia corporation, Invacare Corporation (Invacare) followed its hostile tender offer with a proxy contest to elect directors who would remove Healthdyne's poison pill. *See* Gordon, *supra* note 6, at 533. Invacare's proxy contest to oust the Healthdyne board failed. *See* Michael E. Kanell, *Invacare Loses Battle to Wrest Control of Healthdyne Board: Shareholders Back Proposals That Could Lure Buyer*, THE ATLANTA CONST., July 31, 1997, *available in* 1997 WL 3984533. Invacare's strategy was stymied by the "continuing director" or "dead hand" provision in Healthdyne's pill, which provided that only the directors who adopted the pill, or their hand-picked successors, could redeem it. Gordon, *supra* note 6, at 533. For a discussion of the "dead hand" pill, see John Elofson, *Should Dead Hand Poison Pills Be Sent to an Early Grave?*, 25 SEC. REG. L.J. 303 (1997); Ellen S. Friedenberg & Ed Kaufmann, *"Dead Hand" Poison Pill Upheld*, 68 CORP. (Aspen Law & Bus.) ¶ 23.1 (Dec. 1, 1997); *see also* Gordon, *supra* note 6, at 536-43 (discussing dead hand provision under Delaware's *Unocal* test); Steven Lipin, *Big B's Unusual Poison Pill Sparks Lawsuit by Hostile Suitor Revco*, WALL ST. J., Oct. 1, 1996, at B4 (discussing Big B's dead hand pill). Invacare brought suit to enjoin Healthdyne's dead hand provision and also proposed a bylaw amendment that would dismantle it. *See* Brown & Regner, *supra* note 7, at 4. The U.S. District Court for the Northern District of Georgia upheld the dead hand provision as a proper exercise of board power, based on Georgia corporate statutes which give directors "sole" discretion to set share preferences, and which, according to the court, embrace the notion of "continuing directors." *See Invacare*, 968 F. Supp. at 1580-81; *see also* Brown & Regner, *supra* note 7, at 4 (discussing potential impact of other states' pill validation statutes on dead hand provisions); Gordon, *supra* note 6, at 533 (discussing pertinent Georgia statutes). The Georgia Legislature adopted the statute giving directors "sole" authority to set share preferences in direct response to a federal district court decision which held that pills which discriminate against the person who triggers the pill, known as a "flip in" provision, violated Georgia law. *See* Gordon, *supra* note 6, at 536 (citing West Point-Pepperell, Inc. v. Farley, Inc., 711 F. Supp. 1096 (N.D. Ga. 1989)). The court also held Invacare's proposed bylaw invalid. *Invacare*, 968 F. Supp. at 1582.

[20] *See* Mark A. Stach, *An Overview of Legal and Tactical Considerations in Proxy Contests: The Primary Means of Effecting Fundamental Corporate Change in the 1990s*, 13 GEO. MASON U. L. REV. 745, 745 (1991) (noting that "increased willingness" of institutions to challenge management has encouraged proxy contests); *see also* Philip Scipio, *Once Again, CII Targets Underperformers*, INVESTOR REL. BUS., Oct. 6, 1997, *available in* 1997 WL 8784283 (discussing Council of Institutional Investors' (CII) most recent list of 20 underperforming companies). Institutional investors own "nearly half of the stock of large, public U.S. corporations." E. Norman Veasey, *The Defining Tension in Corporate Governance in*

pills have been a prime target of institutions, who have won some success through active sponsorship of nonbinding shareholder proposals to remove the pill.[21] Organized labor, with significant stock ownership in pension funds, has also become a new force on the corporate governance scene.[22]

In 1997, shareholder activists successfully deployed for the first time a new device to neutralize the poison pill: the

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America, 52 BUS. LAW. 393, 399 (1997) (noting institutional investors' role in "advocating aspirational models of corporate governance"). Groups like Institutional Shareholder Services (ISS) and CII have arisen to provide institutional shareholders with information and assistance. *See* Steven Lipin, *Advisory Firm's Influence Grows in Proxy Fights*, WALL ST. J., Nov. 10, 1997, at C1; *ISS* (last modified April 20, 1998) ‹http://www.cda.com/iss/welcome.html›; *CII* (visited March 16, 1998) ‹http://www.ciicentral.com/›; *see generally Investor Responsibility Research Center* (visited March 16, 1998) ‹http://www.irrc.org/›; *Corporate Governance* (visited March 16, 1998) ‹http://www.corpgov.net/›.

The dramatic increase in institutional ownership has placed "shareholder voice" at the center of the corporate governance debate. *See* Jeffrey N. Gordon, *Shareholder Initiative: A Social Choice and Game Theoretic Approach to Corporate Law*, 60 U. CIN. L. REV. 347, 347 (1991) (noting that institutional ownership reduces "collective action barriers to concerted shareholder activity"); *see also* Karmel, *supra* note 11, at 1158 (discussing institutional investors' impact on corporate governance); John H. Matheston & Brent A. Olson, *Corporate Law and the Longterm Model of Corporate Governance*, 76 MINN. L. REV. 1313, 1315 (1992) (proposing that governance structure should be "responsive to institutional shareholders"); John A. Byrne, *Don't Squelch the Small Shareholder*, BUS. WK., Dec. 29, 1997, at 48 (describing shareholder bylaw as democratic "dialogue").

[21] Half of the fifty-two businesses where precatory anti-pill proposals received a majority vote between 1988 and 1996 subsequently eliminated their pills. *See Lublin*, *supra* note 8. *See also* Mark R. Wingerson & Christopher H. Dorn, *Institutional Investors in the U.S. and the Repeal of Poison Pills: A Practitioner's Perspective*, 1992 COLUM. BUS. L. REV. 223, 242-49 (1992) (discussing reasons institutional investors seek to remove poison pills); Philip Scipio, *Proxy '98 May Be Quiet on Employment: Even with an SEC Reversal on Cracker Barrel, the Focus May Be Elsewhere*, INVESTOR REL. BUS., Sept. 22, 1997, *available in* 1997 WL 8784286 (noting that anti-pill proposals gained ground in 1997). Anti-pill resolutions continue to get the most support among shareholder proposals. *See* Ricki Fulman, *Shareholder Activism: Shareholders Keep Directors Feeling the Heat*, PENSIONS & INVESTMENTS, Feb. 9, 1998, at 19.

[22] *See* Randall S. Thomas & Kenneth J. Martin, *Should Labor Be Allowed to Make Shareholder Proposals?*, 73 WASH. L. REV. 41, 42 (1998); Paul Sweeney, *Clash by Proxy*, ACROSS THE BOARD, May 1, 1996, at 21, *available in* 1996 WL 10079586; *see also* Laura M. Litvan, *National Issue Unions Take Stock in Companies*, INVESTOR'S BUS. DAILY, Dec. 12, 1997, at A1 (discussing unions' new role as shareholder-activists).

binding shareholder bylaw proposal. In *International Brotherhood of Teamsters General Fund v. Fleming Co.*, a federal district court in Oklahoma ordered Fleming Companies, Inc. (Fleming) to include a shareholder-sponsored anti-pill bylaw amendment proposal in its proxy materials.[23]

Following the decision, the Fleming board sought to dampen support for the anti-pill bylaw by voluntarily dropping its pill,[24] but it was literally too little too late. When the measure went before shareholders at the annual meeting, 61.9% of the voting shares approved the bylaw.[25] If upheld on appeal, the Fleming board will not be able to institute a new poison pill without approval by a shareholder majority.[26] In addition, well-known arbitrageur and shareholder activist Guy Wyser-Pratte has found success this year with his anti-pill bylaw, which has been dubbed the "chewable poison pill."[27]

The purpose of this comment is to examine the ramifications of the anti-pill bylaw on corporate governance. Part II will discuss the movement by unions and Guy Wyser-Pratte to pass anti-pill bylaws. Part III will analyze the statutory basis for the use of the bylaw amendment mechanism. Part IV will suggest management strategies to defend against such bylaw proposals, as well as suggest a legislative response.

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[23] *See* International Bhd. of Teamsters Gen. Fund v. Fleming Co., No. CIV-96-1650-A, 1997 U.S. Dist. LEXIS 2979, at *1 (W.D. Okla. Jan. 24, 1997); *see also* Philip Scipio, *Binding Resolutions Are on the Way: Shareholders Are Taking Their Activist Agenda to the Next Level*, INVESTOR REL. BUS., May 19, 1997, *available in* 1997 WL 8783979 (noting that binding shareholder proposal is developing trend).[23]

[24] Gordon, *supra* note 6, at 544.

[25] *See* Henry Lesser et al., *Emerging Trends in the Use of Shareholder Bylaw Amendments*, SC09 A.L.I.-A.B.A. COURSE OF STUDY 499, 508 (1997).

[26] *Id. See* Gypsy Hogan, *Poison Pill Bitter to Fleming Voters*, THE DAILY OKLAHOMAN, May 1, 1997, at 17; *see also* Fulman, *supra* note 21 (noting ramifications of *Fleming* decision as "precedent-setting").

[27] *See* Jonathan R. Macey, *Manager's Journal: A Poison Pill That Shareholders Can Swallow*, WALL ST. J., May 4, 1998, at A22.

II. BINDING ANTI-PILL BYLAW PROPOSALS

A. *First Success: The Fleming Story*

The situation which would eventually become the spark for the nascent shareholder bylaw amendment movement started typically enough. The shareholders of Fleming, an Oklahoma-based grocery wholesaler, voted on a precatory shareholder proposal asking the board to redeem its poison pill.[28] The anti-pill proposal, advanced by the International Brotherhood of Teamsters General Fund (Teamsters), won over 60% of the vote.[29] Despite the shareholders' wishes, the Fleming board voted to renew its pill for another ten years.[30]

This turn of events led the Teamsters to launch a more potent attack on the pill. Pursuant to Rule 14a-8 of the Securities Exchange Act of 1934,[31] the Teamsters submitted a mandatory bylaw amendment proposal for inclusion in Fleming's 1997 proxy materials that would delete the existing poison pill and require shareholder approval to adopt any future pill.[32] Fleming's board refused to include the proposal

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[28] *See* Lesser, *supra* note 25, at 509. The Fleming pill was soon due to expire. *Id.*

[29] *See Fleming Cos.: Board Decides to Terminate Company's Poison-Pill Plan*, WALL ST. J., March 19, 1997, at B4.

[30] John C. Coffee, Jr., *The Bylaw Battlefield: Can Institutions Change the Outcome of Corporate Control Contests?*, 51 U. MIAMI L. REV. 605, 612 (1997).

[31] 17 C.F.R. § 240.14a-8. Under Rule 14a-8, shareholder proposals must be included in corporate proxy materials unless they fall into the rule's exceptions. *See* Coffee, *supra* note 30, at 608-09; *see also* Theresa A. Gabaldon, *Shareholder Proposals*, SC09 A.L.I.-A.B.A. COURSE OF STUDY 659, 669 (1997) (discussing impact of 14a-8 on proposed bylaw amendments). For a discussion of the SEC's recent changes to Rule 14a-8, see Bryn Vaaler, *SEC Finalizes Changes to Shareholder Proposal Rules*, 69 CORP. (Aspen Law & Bus.), ¶ 13.1 (July 1, 1998).

[32] The text of the Teamsters' proposal is as follows:

> Poison Pills (Shareholders Rights Plans)
>
> A. The Corporation shall not adopt or maintain a poison pill, shareholder rights plan, rights agreement or any other form of "poison pill" which is designed to or has the effect of making acquisition of large holdings of the Corporation's shares of stock more difficult or expensive (such as the 1986 "Rights Agreement"), unless such plan is first approved by A MAJORITY shareholder vote. The company shall redeem any such rights now in effect. The affirmative vote of a majority of

in its proxy materials and sought a declaratory judgment in state court, contending that the proposal could be excluded under Rule 14a-8(c) because it "was not a proper subject for shareholder action" under Oklahoma law.[33] The Teamsters brought suit in federal court for declaratory and injunctive relief to compel the Fleming board to include its shareholder proposal.[34]

The legal arguments in the case turned on interpretation of Oklahoma's corporate code, which was modeled on Delaware's General Corporation Law (DGCL).[35] In its motion for summary judgment, Fleming argued that the anti-pill bylaw violated the statutory provisions which (1) vest authority in the board to manage the corporation's business and affairs,[36] and (2) grant the board the right to set share preferences pursuant to the corporate charter.[37] The Teamsters relied on the statutory provision that grants shareholders the power to "adopt, amend or repeal bylaws . . . relating to the business of the corporation, the conduct of its affairs, and . . . rights or powers of its stockholders, directors, officers or employees."[38] In January 1997, the United States District Court for the Western District of Oklahoma ordered Fleming to include the Teamsters' resolution in its proxy materials.[39] The

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> shares shall suffice to approve such a plan.
>
> B. This article shall be effective immediately and automatically as of the date it is approved by the affirmative vote of the holders of a majority of the shares, present in person or by proxy at a regular or special meeting of the shareholders.
>
> C. Notwithstanding any other provision of these bylaws, this Article may not be amended, altered, deleted or modified in any way by the Board of Directors without prior shareholder approval.

Lesser, *supra* note 25, at 521.

[33] Lesser, *supra* note 25, at 509.

[34] *Id.*

[35] *See* Brown & Regner, *supra* note 7, at 5; Coffee, *supra* note 30, at 612.

[36] *See* Lesser, *supra* note 25; OKLA. STAT. ANN. tit. 18 § 1027 (1986). Section 1027 corresponds to DGCL § 141. *See* DEL. CODE ANN. tit. 8, § 141(a) (1991).

[37] *See* Lesser, *supra* note 25; OKLA. STAT. ANN. tit. 18 § 1038 (1986). Section 1038 corresponds to DGCL § 157. *See* DEL. CODE ANN. tit. 8, § 157 (1991).

[38] *See* Lesser, *supra* note 25, at 510; OKLA. STAT. ANN. tit. 18 § 1013 (1986). The DGCL provision is § 109(b). *See* DEL. CODE ANN. tit. 8, § 109(b) (1991).

[39] International Bhd. of Teamsters Gen. Fund v. Fleming Co., No. CIV-96-

court subsequently denied Fleming's motion to suspend the order pending appeal, holding that Fleming failed to show irreparable harm to the corporation.[40] The court noted that Fleming "made no claim of specific harms to be suffered" and failed to show "that the stock price will be affected or that the shareholders, who are, in fact, the corporation, will suffer any harm."[41] In response to Fleming's argument that a stay would serve the "public interest," the court countered that it "consider[ed] the operation of shareholder democracy to be very much in the public interest."[42]

1650-A, 1997 U.S. Dist. LEXIS 2979, at *1 (W.D. Okla. Jan. 24, 1997). The court based its decision on the broad grant of shareholder authority in § 1013, noting that the board's right to set share preferences "does not foreclose shareholder action in this matter." *Id. See Fleming Must Submit Antitakeover Plan to Shareholder Vote*, WALL ST. J., Jan. 16, 1997, at A4; *Judge Orders Fleming Vote: Shareholders Will Have Chance to Rescind Poison Pill*, TULSA WORLD, Jan. 16, 1997, *available in* 1997 WL 3622202.

[40] International Bhd. of Teamsters Gen. Fund v. Fleming Co., No. CIV-96-1650-A, 1997 U.S. Dist. LEXIS 2979, at *2 (W.D. Okla. Feb. 19, 1997).

[41] *Id.*

[42] *Id.* at *3. An investment fund proposed a binding bylaw resolution at SuperValu, Inc. to require a shareholder vote on poison pill plans. *See* Matt Greco, *Shareholders to Focus on Executive Compensation*, INVESTOR'S BUS. DAILY, Mar. 2, 1958, *available in* 1998 WL 10504443. In April, SuperValu withdrew its written request for a no-action letter from the Securities Exchange Commission (SEC), in which the company stated its intention to omit the proposal from its proxy statement. *See* SuperValu, Inc., SEC No-Action Letter, 1998 WL 185074 (Apr. 15, 1998). The Company and the fund—the Amalgamated Bank of New York LongView Collective Investment Fund—agreed to resolve their dispute out of court. *Id.* Litigation in this matter would have landed in Delaware court. *See* Greco, *supra*. The fund proposed a binding bylaw after the SuperValu board failed to respond to precatory proposals which received a majority vote at the previous three annual meetings. *See* SuperValu, Inc., SEC No-Action Letter, *supra*. The binding proposal:

> The Company shall not adopt or maintain any rights agreement, share purchase, rights plan or similar agreement, commonly referred to as a "poison pill," which is designed to impede, or has the effect of impeding, the acquisition of a block of stock in excess of a specified threshold and/or merger or other transaction between a significant shareholder and the Company, unless such plan or agreement has previously been approved by holders of a majority of the outstanding shares of stock at a general or special meeting of shareholders, and the Company shall redeem any such plan or agreement in effect as of the date of adoption of this Article of the Bylaws, including without limitation the Company's

B. May Department Stores and Harrah's: Unions Launch Direct Proxy Solicitations

Shortly after the Teamsters came forward with their proposed bylaw amendment, the Union of Needletrades and Industrial Textile Employees (UNITE) initiated a similar antipill bylaw proposal at May Department Stores (May).[43] Instead of submitting their proposal for inclusion in May's proxy statement, UNITE filed its own with the Securities Exchange Commission (SEC) and began a direct solicitation of the May shareholders.[44] The May Board's use of discretionary voting authority became the subject of litigation after May asserted a

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> 1989 Rights Agreement. Notwithstanding any other provision of these bylaws, this Article may not be amended, modified or repealed, except by holders of a majority of the outstanding shares of stock.

Id.

[43] The UNITE proposal:

> RESOLVED, that pursuant to Section 109 of the Delaware General Corporation Law and Article XIII of the Company's By-Laws, the share owners of The May Department Stores Company (the "Company") hereby amend the Company's By-Laws to add the following article, such amendment to be effective immediately upon approval by holders of a majority of the outstanding shares of stock present, in person or by proxy, at the meeting of share owners at which the resolution is proposed:
>
> The Company shall not adopt or maintain any rights plan or similar agreement commonly referred to as a "poison pill," which is designed to impede, or has the effect of impeding, the acquisition of a block of stock in excess of a specified threshold and/or merger or other transaction between a significant share owner and the Company, unless such plan or agreement has theretofore been approved by the holders of a majority of the outstanding shares of stock at a general or special meeting of share owners, and the Company shall redeem any such plan or agreement in effect as of the date of adoption of this Article of the By-laws, including without limitation the Company's 1994 Rights Agreement. Anything to the contrary notwithstanding, this Article may not be amended, modified or repealed, except by holders of a majority of the outstanding shares of stock.

see Lesser, *supra* note 25, at 523.

[44] Lesser, *supra* note 25, at 508. For a discussion of the SEC's response to binding shareholder bylaw proposals, see Seth Goodchild & Daniel J. Buzzetta, *Shareholder Bylaws: A Threat to the Board?*, CORP. BOARD, May 15, 1998, at 10, *available in* 1998 WL 12017521.

55% majority victory.[45] UNITE filed suit, contending that "but for" May's confusing proxy process and illegal casting of discretionary authority, the bylaw amendment would have passed.[46] The United States District Court for the Southern District of New York granted May's motion to dismiss UNITE's complaint, holding that the May board properly exercised its discretionary authority.[47]

The Hotel Employees and Restaurant Employees International Union (HERE) also sponsored a direct proxy solicitation in early 1997, in support of an anti-pill bylaw at Harrah's Entertainment, Inc. (Harrah's).[48] Shareholders approved the bylaw by a 51% majority, but it was not enough to meet a supermajority provision in the corporate charter.[49] Representatives of HERE argued that the supermajority provision was an improper impediment to shareholder democracy, but the union did not follow UNITE in filing suit.[50]

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[45] *See* Fred Faust, *May Proxy Proposals Defeated: Shareholders Take Management's Side*, ST. LOUIS POST DISPATCH, June 10, 1997, at 14C, *available in* 1997 WL 3347046. May's board accused UNITE of using the bylaw proposal process to coerce May into cooperating with the union's organizing efforts at a May clothing supplier in Canada. *See* Lesser, *supra* note 25, at 512; Lublin, *supra* note 8. UNITE's director of corporate affairs called the allegations "absolutely untrue" and an overreaction by May. Lublin, *supra* note 8.

[46] *See* Union of Needletrades v. May Dep't Stores Co., No. 97 CIV.3120 (JGK), 1997 WL 714886, at *3 (S.D. N.Y. Nov. 14, 1997).

[47] *Id.* at *4. *See May Department Stores Co.: Union Is Set Back in Suit Over Anti-Takeover Plan*, WALL ST. J., Nov. 24, 1997, at B6. In addition to changes to Rule 14a-8, the SEC recently modified Rule 14a-4 regarding management's exercise of discretionary voting authority when proposals are made from the floor of a meeting or by independent proxy solicitation. For an excellent discussion of the impact of these changes, see Vaaler, *supra* note 31, at 4-6. Vaaler suggests that if the new procedures had been in place and followed by UNITE, the union's proposal likely would have passed. *Id.* at 5-6. He notes that shareholder groups with the resources to conduct direct proxy solicitations may use the new rule to get around the exclusions of Rule 14a-8. *Id.* at 7.

[48] *See* Lesser, *supra* note 25, at 511. The HERE proposal:

> The Company shall not adopt or maintain a "poison pill," shareholder rights plan, rights agreement or any other form of "poison pill" which is designed to or has the effect of making acquisition of large holdings of the Company's shares of stock more difficult or expensive (such as the July 19th, 1996 "Rights Agreement"), unless such plan is first approved by A MAJORITY shareholder vote. The Company shall redeem any such rights now in effect. The affirmative vote of a majority of shares votes shall suffice to approve such a plan. This Section shall be effective immediately and automatically as of the date it is approved by the shareholders. Notwithstanding any provision of these by-laws, this Section may not be amended, altered, deleted or modified in any way by the Board of Directors without prior shareholder approval.

C. The Wyser-Pratte Shareholder Rights Bylaw

Arbitrageur Guy Wyser-Pratte is credited with launching the first direct attack on a poison pill through a binding bylaw amendment, in an effort to eliminate the pill that allowed Wallace Computer (Wallace) to "just say no" to a deal with Moore Corporation.[51] Wyser-Pratte initiated a direct proxy solicitation for a "shareholder rights bylaw," which provided that 90 days after the company receives a cash takeover offer at a 25% or higher premium, the board of directors must drop its pill and stop resisting.[52] The proposal at Wallace was

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Id. at 522.

[49] *Id.* at 511.

[50] *Id.* at 512; *but see* Centaur Partners, IV v. National Intergroup, Inc., 582 A.2d 923, 927 (Del. 1990) (upholding supermajority requirement to amend bylaws). *See also* Laurel Campbell, *Casinos-Harrah's Could Go To Court Over "Poison Pill,"* THE COMM. APP., May 6, 1997, at B5 (discussing results of HERE proposal).

[51] *See* Lesser, *supra* note 25, at 505-06; *see supra* note 17.

[52] *See* Gordon, *supra* note 6, at 511. The text of Wyser-Pratte's bylaw:

> If a fully financed tender offer is made to purchase all of the Company's outstanding shares of Common Stock for cash at a price that is at least 25 percent greater than the average closing price of such shares on the New York Stock Exchange during the 30 days prior to the date on which such offer is first published or sent to security holders and the Board of Directors opposes such offer, the Board of Directors shall terminate all defensive measures against such offer at the end of the ninetieth day after such offer is first published or sent to security holders, unless the Board of Directors' policy of opposition to such offer is approved by a vote of a majority of shares of Common Stock present and entitled to vote on the subject at a meeting of stockholders which is held on or before such ninetieth day and at which a quorum is present; provided, however, that the Board of Directors shall not be required to terminate defensive measures against such offer at the end of such ninetieth day unless at such time the offer has an expiration date which is at least ten business days thereafter. Notwithstanding anything to the

clearly within reach when one important institutional investor decided at the wire to switch its vote.[53]

Wyser-Pratte subsequently launched a similar effort to pass the bylaw at Rexene Corporation (Rexene), in response to the Rexene board's recalcitrance regarding hostile bidder Huntsman Corporation (Huntsman).[54] Along with investment management firm Spears, Leeds & Kellogg, Wyser-Pratte initiated a proxy fight to oust the Rexene board and called a special meeting for a vote.[55] The board thwarted a legal challenge to its selection of a disadvantageous record date for the meeting,[56] but this time Wyser-Pratte ultimately got what he wanted — Rexene agreed to merge with Huntsman.[57]

Wyser-Pratte found even greater success at Pennzoil Corporation, where the board, like Wallace Computer's, had used

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> contrary contained in Section 2.5 of the By-Laws, unless the record date for such stockholders meeting was set prior to the date on which such offer was first published or sent to security holders, the record date for such meeting shall be at least five business days after the date on which the Company files its statement of position with respect to such offer in accordance with Rule 14e-2 of the Securities Exchange Act of 1934, as amended. At such time as it is required, pursuant to the first sentence of this by-law, to terminate defensive measures against such offer, the Board of Directors shall redeem the outstanding Rights under the Rights Agreement dated as of March 14, 1990 between the Company and Harris Trust and Savings Bank, as Rights Agent, or any successor agreement. Prior to the end of such ninetieth day unless the Board's policy of opposition to such offer has been approved by a stockholder vote as provided in this by-law, the Board of Directors shall take such reasonable actions as are necessary to preserve the possibility of satisfying the conditions to such offer after such ninetieth day. This Section 7.8 may only be amended or repealed by a stockholder vote pursuant to Section 7.1 of the By-Laws.

See Lesser, *supra* note 25, at 520.

[53] *See* Gordon, *supra* note 6, at 511.

[54] *See Huntsman Snares Its Prey In Rexene*, MERGERS & RESTRUCTURING, Aug. 25, 1997, *available in* 1997 WL 9077950.

[55] *See Rexene Accepts Bid By Huntsman Corp. Totaling $300 Million*, WALL ST. J., June 10, 1997, at B2; *see also* William Freedman, *Huntsman-Rexene: An Exceptional Proxy Fight*, CHEM. WK., Sept. 10, 1997, at 36 (discussing Huntsman acquisition of Rexene).

[56] *See* Wyser-Pratte v. Smith, C.A. No. 15545-NC, 1997 WL 153806, at *2 (Del. Ch. March 18, 1997).

[57] *See Rexene Accepts Bid by Huntsman Corp., supra* note 55.

its poison pill to block a premium bid from Union Pacific Resources (UPR), even though 61.5% of its shareholders had tendered their shares.[58] Wyser-Pratte filed a proxy statement with the SEC, which included his shareholder rights bylaw, to be submitted to the Pennzoil shareholders.[59] Rather than risk defeat, on April 6, 1998, Pennzoil management agreed to incorporate elements of Wyser-Pratte's bylaw into its own poison pill.[60] Wyser-Pratte's pill has recently been dubbed the "chewable poison pill" because it transforms the pill into a pro-shareholder device.[61] Although the legal validity of the bylaw is unresolved, the birth of the "chewable" pill demonstrates the power-shifting potential of a shareholder bylaw proposal.

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[58] *See* Tim Smart, *Ignoring the Sting of Takeover Foes: Companies Pressing Hostile Bids As Need To*, WASH. POST., Mar. 7, 1998, at H1. UPR withdrew its $4.2 billion cash offer in November 1997, after the Pennzoil board had rejected it twice. *See* Michael Davis, *Shareholder Tries to Curb Poison Pill Use*, HOUS. CHRON., Jan. 14, 1998, at 2, *available in* 1998 WL 3554758; Peter Fritsch, *Pennzoil Holder Proposes Limiting 'Poison Pill' Use*, WALL ST. J., Nov. 19, 1997, at B5; *see also* Peter Fritsch, *Union Pacific Resources May Drop Pennzoil Bid*, WALL ST. J., Nov. 12, 1997, at A3 (chronicling UPR's bid for Pennzoil). Pennzoil filed suit against Wyser-Pratte to enjoin him "from making 'false and misleading statements' to Pennzoil shareholders." *Pennzoil Files Suit Against Wyser-Pratte*, WALL ST. J., Mar. 16, 1998, at B5.

[59] *See Shareholder Considers a Proxy Battle Against Pennzoil Management*, PETROMONEY, Jan. 19, 1998, *available in* 1998 WL 7918799. Based on a comparison of UPR's $84 per share bid and Pennzoil's post-bid trading price of $61.88 per share, Wyser-Pratte claimed that rejection of UPR's bid resulted in a $1.04 billion loss to shareholders. *See Angry Pennzoil Shareholder Seeks Seat on Board*, GAS DAILY, Jan. 16, 1998, *available in* 1998 WL 7665758. The Pennzoil board based the decision on its belief that its "strategic plan" would bring shareholders higher value, but the board did not provide details of its plan. *See Corporate News: Union Pacific Resources Group, Inc.; Pennzoil Co.*, ENERGY ALERT, Jan. 29, 1998, *available in* 1998 WL 10107070.

[60] *See* Michael Davis, *Pennzoil's Shareholders Meeting Quiet: No Mention Made of Controversy Over Union Pacific Resources*, HOUSTON CHRON., May 8, 1998, at 2; *see also* Leslie P. Norton, *Expiration Date: If This Stock Market Falters, Poison Pills Could Become Hot Topic Again*, BARRON'S, July 6, 1998, at 17 (discussing Wyser-Pratte's pill).

[61] *See* Davis, *supra* note 60 (discussing benefits of "chewable pill"). The new Pennzoil pill "dissolves" when a bidder "makes an all-cash tender offer for the company at 35% or above the company's market price." *Id.* Wyser-Pratte hopes to accomplish similar results at Telxon Corp. *Id.*

III. ANTI-PILL BYLAW AMENDMENTS: SQUARE PEG OR STATUTORY FIT?

A. *Delaware: §§ 109, 141 & 157*

The federal judge in *Fleming* clearly held that under Oklahoma law, a bylaw amendment restricting the board's power to implement a pill is within the scope of shareholder authority.[62] At issue is the judge's interpretation of the relevant statutes, which as previously mentioned, are patterned on Delaware's.[63] An analysis of the language in the Delaware provisions is far from conclusive.

Section 109(a) of the Delaware General Corporation Law (DGCL) provides that "the power to adopt, amend or repeal by-laws *shall* be in the stockholders entitled to vote."[64] This same power *may* be given to the board of directors in the certificate of incorporation, but "[t]he fact that such power has been so conferred upon the directors . . . shall not divest the stockholders . . . nor limit their power to adopt, amend or repeal by-laws."[65] This outright grant of power to shareholders is filled out by § 109(b), which details that "[t]he by-laws may contain any provision, not inconsistent with law or with the certificate of incorporation, relating to the business of the corporation, the conduct of its affairs, and its rights or powers or the rights or powers of its stockholders, directors, officers or employees."[66] This section "makes it clear that stockholders always have the power to make, alter or repeal bylaws."[67] However § 141(a) explicitly provides that "[t]he business and affairs of every corporation organized under this chapter *shall* be managed by or under the direction of a board of directors, except as may otherwise be provided in this chapter or in its certificate of incorporation."[68]

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[62] *See* Int'l Bhd. of Teamsters Gen. Fund v. Fleming Co., No. CIV-96-1650-A, 1997 U.S. Dist. LEXIS 2979, at *3 (W.D. Okla. Feb. 19, 1997).

[63] *See* Brown & Regner, *supra* note 7, at 5; Coffee, *supra* note 30, at 612.

[64] DEL. CODE ANN. tit. 8, § 109(a) (1986) (emphasis added).

[65] *Id.*

[66] DEL. CODE ANN. tit. 8, § 109(b) (1986).

[67] R. FRANKLIN BALOTTI & JESSE A. FINKELSTEIN, THE DELAWARE LAW OF CORPORATIONS AND BUSINESS ORGANIZATIONS, at 44 (1995).

Both of these provisions contain outright grants of broad authority, not subject to change in the certificate of incorporation, but subject to limiting language. The crux of the problem appears to be threefold: (1) the interpretation of the words in § 109(b) *"not inconsistent with law or with the certificate of incorporation,"*[69] and the extent of their limitation on shareholder authority, (2) the interpretation of the words in § 141(a) *"except as may otherwise be provided in this chapter or in its certificate of incorporation,"*[70] and the extent of their limitation on the power of the board of directors, and (3) most importantly, the relationship between the two provisions. That the board is granted the exclusive right to manage the business and affairs of the corporation has not been disputed, and it is an argument that corporate boards have wielded successfully.[71] But clearly, under Delaware law, shareholders are authorized to adopt bylaws "relating to" the corporation's business.[72]

In the case of an anti-pill proposal, the tension between these two provisions is exacerbated by § 157, which provides that the board of directors may determine stock rights, such as poison pills, unless such authority is limited in the certificate of incorporation.[73] In *Fleming*, the board contended that the Teamsters' anti-pill bylaw impermissibly impinged on the board's exclusive power, granted in the certificate of incorporation, to establish rights plans.[74] The Teamsters argued that the board's ability to institute a poison pill is qualified by the shareholders' statutory right to adopt bylaws relating to the board's power.[75] Neither argument completely solves the problem — although bylaws are, by definition, subservient to the corporate charter, the charter is likewise subject to the corporate code.[76]

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[68] DEL. CODE ANN. tit. 8, § 141(a) (1986) (emphasis added).

[69] § 109(b).

[70] § 141(a).

[71] This canon of corporate law finds expression in the business judgment doctrine of judicial deference to a board's substantive decisions, applied by courts as the business judgment rule. *See* PRINCIPLES OF CORPORATE GOVERNANCE: ANALYSIS & RECOMMENDATIONS § 4.01(c) (1994).

[72] § 109(a). The intersecting language of § 109 and § 141 has been described as "a recursive loop." Gordon, *supra* note 6, at 546. The limiting words "unless otherwise provided" in § 141 would appear to encompass shareholder bylaws in § 109, but the bylaws themselves may not be "inconsistent with law." *Id.* at 547.

[73] DEL. CODE ANN. tit. 8, § 157 (1986).

[74] *See* Lesser, *supra* note 25.

A review of Delaware case law is equally unhelpful in trying to determine how Delaware courts would treat an anti-pill shareholder bylaw. In *Datapoint Corp. v. Plaza Securities Co.*,[77] the Delaware Supreme Court considered the validity of a board-passed bylaw which limited shareholder ability to act by written consent. Title 28, section 228 of the Delaware Code grants shareholders the power to act by written consent unless that power is negated in the certificate of incorporation.[78] The bylaw in question delayed the effectiveness of shareholder action by written consent for sixty days.[79] The Datapoint board argued that corporate elections, including those by written consent, could be properly regulated through bylaws.[80]

The court said the central issue was not whether § 228 allowed the board to regulate its procedures, but whether the "bylaw 'directly conflicts' with § 228's grant of power to the shareholders."[81] Describing the sixty-day delay as "arbitrary" and "unreasonable,"[82] the court upheld the chancery court's ruling that the bylaw was ""totally at odds" with the shareholders' statutory power to act by written consent.[83] This ruling appears to support management's position on poison pills because like § 228, which gives shareholders the power to act by written consent unless negated in the certificate of incorporation, § 141 gives the board the residual power to manage unless that power is limited in the charter. Under this interpretation, a shareholder bylaw limiting the board's power to manage would directly conflict with the statute.

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[75] *Id.* at 510-11. The Teamsters characterized the shareholders' authority as a residuary "right to review." *Id.*

[76] The Teamsters pointed out that boards receive their power to set preferences from the certificate of incorporation, not from an outright statutory grant; Fleming noted that bylaws are, by definition, subservient to the corporate charter. *See* Lesser, *supra* note 25, at 509-10. The Delaware courts have "firmly adhered" to the rule that bylaws which contradict the certificate of incorporation will be deemed void. *See* R. FRANKLIN BALOTTI & JESSE A. FINKELSTEIN, THE DELAWARE LAW OF CORPORATIONS AND BUSINESS ORGANIZATIONS, § 1.12, at 1-27 (2nd ed. 1990 & 1993 Supp.). However, courts will make an effort to avoid a conflict by interpreting bylaws as harmonious with the charter and the code where possible. *Id.* "Reasonable" bylaw "restrictions on a statutory or common law right, or a right granted by the certificate of incorporation, may be upheld." *Id.* at 1-28.

[77] 496 A.2d 1031, 1032 (Del. 1985).

[78] *See* DEL. CODE ANN. tit. 8, § 228 (1986).

[79] *Datapoint*, 496 A.2d at 1036.

[80] *Id.* at 1034.

[81] *Id.* at 1035. The court added that "[t]he determinative question is wheth-

At the same time, *Datapoint* and its progeny also demonstrate that shareholder action, pursuant to statutory authority, is more than a formalistic exercise that a board can limit or circumvent unilaterally. The "central importance" of the shareholder franchise was confirmed in *Blasius Industries, Inc. v. Atlas Corp.*[84] There, Atlas Corporation added two members to its board in an attempt to circumvent the shareholders' election of a new majority of directors by written consent.[85] Chancellor Allen held that action taken by the

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er . . . [the] bylaw conflicts with the letter and intent" of the statute. *Id.*

[82] *Id.* at 1036.

[83] *Id.* at 1035. However, the court suggested that non-intrusive "provisions for ministerial review" of shareholder action would be allowed. *Id.* at 1036. The supreme court reaffirmed the *Datapoint* holding in *Allen v. Prime Computer, Inc.*, when it struck down a bylaw which delayed the effectiveness of shareholder action by written consent for twenty days. Allen v. Prime Computer, Inc., 540 A.2d 417, 418 (Del. 1988). In *Allen*, the court outlined the factors it considered relevant to "evaluating the reasonableness of a bylaw" aimed at giving the board "ministerial review" of consent actions. *Allen*, 540 A.2d at 420. The court stated:

> First, a court must determine the purpose sought to be served. A bylaw whose real purpose is delay of shareholder action is per se unreasonable. Second, the court should consider the impact of the bylaw upon the effective exercise of the power conferred under § 228. Finally, the bylaw should contain the minimum requisites for a reliable and prompt ministerial review to ensure the orderly function of corporate democracy.

Id. The court invalidated the board's "interference with a fundamental stockholder franchise." *Id.* at 421.

[84] Blasius Indus., Inc. v. Atlas Corp., 564 A.2d 651 (Del. Ch. 1988).

[85] *Blasius*, 564 A.2d at 662.

board "for the primary purpose of preventing the effectiveness of a shareholder vote"[86] is subject to a "compelling justification test"[87] test, even where the board has acted in good faith.[88] However, it is noteworthy that board adoption of a normal poison pill does not invoke *Blasius*—the "compelling justification test" appears to have limited application.

Since the statutes and Delaware case law offer little guidance, the apparent conundrum of binding shareholder bylaw amendments becomes an issue of policy: What *should* the answer be? One writer has suggested four different distinctions that might guide Delaware courts.[89] First, ordinary business decisions have long been recognized by Delaware courts as the exclusive domain of corporate boards, while "fundamental" changes such as mergers require shareholder approval.[90] Under this approach, shareholder bylaws relating to fundamental decisions would be permissible, while those that would affect ordinary decision-making would not.[91] Second, shareholder attempts to affirmatively command the board to take a certain action, such as hire Miss X, have been rejected by the courts,[92] but bylaws that serve as a "negative constraint"—that is, that require a shareholder vote on specified board actions—have been successful.[93] Under this theory, a shareholder bylaw which requires a shareholder vote on future board action would pass muster, while a bylaw requiring the board to take a certain action would not.[94] The third distinction, between procedure and substance, would operate similarly. Bylaws requiring certain procedural steps would likely be upheld, while those addressing specific substantive issues would not.[95] Finally, bylaws aimed at corporate governance issues are distinct from bylaws aimed at "only a single business decision."[96] A bylaw that addresses the balance of power between the shareholders and the board, such as requiring a shareholder vote on institution of a poison pill, would fit within any of these schemes.[97]

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[86] *Id.* at 660. Chancellor Allen recognized that the validity of the board's action "involve[d] the question who, as between principal and agent, has authority with respect to a matter of internal corporate governance." *Id.*

[87] *Id.* at 661. *See generally* Gregory S. Schaer, Comment, *Blasius Industries, Inc. v. Atlas Corp.: Closer Scrutiny of Board Decisions under the "Compelling Justification" Standard*, 16 DEL. J. CORP. L. 639 (1991) (discussing "compelling justification" test).

[88] *Blasius*, 564 A.2d at 663. In deciding against a per se rule of invalidity, Chancellor Allen noted that there may be cases where a board's effort to "thwart a shareholder vote" might be justified. *Id.* at 662.

[89] *See* Coffee, *supra* note 30, at 613-14.

[90] *Id.*

[91] *Id.* at 614.

[92] *See* Auer v. Dressel, 118 N.E.2d 590 (N.Y. 1954).

[93] Coffee, *supra* note 30, at 614.

B. Model Business Corporation Act: §§ 8.01(b) & 10.20

States operating under the Model Business Corporation Act (MBCA) are in the same situation as Delaware. Like Delaware, most state corporate codes grant the power to manage the corporation to the board, and the power to adopt bylaws to the shareholders. Thirty-eight states follow § 8.01(b) of the MBCA, which states that "[a]ll corporate powers shall be exercised by or under the authority of, and the business and affairs of the corporation managed under the direction of, its board of directors."[98] Unlike the DGCL, § 10.20(a) gives corporate boards the right to amend or repeal the bylaws as a default rule.[99] However, the articles of incorporation may "reserve this power exclusively to shareholders in whole or in part,"[100] and even where the board's authority is not negated in the articles, its ability to amend shareholder bylaws may be limited by the shareholders.[101] Section 10.20 clearly gives shareholders the greater authority regarding bylaws, adding that "[a] corporation's shareholders may amend or repeal the corporation's bylaws even though the bylaws may also be amended or repealed by its board of directors."[102] The commentary to Alabama's bylaw provision notes that under § 10.20, the shareholders retain the ability to amend the bylaws with no need to reserve it in the articles of incorporation.[103]

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[94] *Id.*

[95] *Id.*

[96] *Id.*

[97] *See also* Gordon, *supra* note 6, at 549-50 (discussing treatment of potential types of anti-pill bylaws under Delaware law).

[98] *See* MODEL BUS. CORP. ACT. ANN. [hereinafter MBCA] § 8.01 statutory comparison at 8-10 (1996 Supp.); REV. MODEL BUS. CORP. ACT. [hereinafter RMBCA] § 8.01 (1984). Section 8.01(b) "recognizes that the powers of the board . . . may be limited by express provisions in the articles of incorporation." RMBCA § 8.01 official cmt. (1984).

Section 6.24 grants the board of directors the authority to set share preferences: "A corporation may issue rights, options, or warrants for the purchase of shares of the corporation. The board shall determine the terms upon which the rights, options, or warrants are issued, their form and content, and the consideration for which the shares are to be issued." RMBCA § 6.24.

[99] *See* RMBCA § 10.20(a). Both the shareholders and the board may amend the bylaws in 30 states. MBCA § 10.20 statutory comparison at 10-77. All but six

C. *Survey of Other States*

Some states have unique statutory provisions affecting the balance of power between the board and the shareholders. They do not provide an answer to the binding shareholder bylaw question, but these laws could be a significant factor in a determination of public policy in that particular state. A few provisions are decidedly pro-shareholder. For example, in Minnesota, three percent shareholders have the ability to propose amendments directly to the corporate charter.[104] This statutory provision allows relatively small shareholders to propose charter amendments that would totally disarm a board's defensive tactics, including its most effective de-

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of these states allow the power to amend bylaws to be reserved exclusively to the shareholders in the charter. *Id.*

[100] RMBCA § 10.20(a)(1).

[101] RMBCA § 10.20(a)(2). The power to amend "includes the adoption of a bylaw on a new subject." § 10.20 official cmt.

[102] RMBCA § 10.20(b).

[103] *See* ALA. CODE § 10-2B-10.20 (1994).

[104] MINN. STAT. ANN. § 302A.135(2) (West 1985). In North Dakota, five percent shareholders can propose a charter amendment. N.D. CENT. CODE § 10-19.1-19(2) (1995). Shareholders in both states may also take any action the board is authorized to take by a unanimous shareholder vote. *See* MBCA § 8.01 statutory comparison at 8-11. Along with Pennsylvania and Nebraska, these states also outline "certain bylaws the board cannot amend." MBCA § 10.20 statutory comparison at 10-79.

fense—the poison pill. Although the Georgia corporate code has a pro-pill provision, a bylaw "establishing staggered terms for directors may only be adopted, amended or repealed by the shareholders."[105] Maine's corporate code grants the power to amend bylaws to the shareholders and the board, but a board may not amend or repeal a shareholder-sponsored bylaw within two years of its passage.[106]

Other states have apparently made corporate policy determinations in favor of board predominance. For example, Nevada's code explicitly provides that the board "has *full control* over the affairs of the corporation,"[107] and along with Ohio, states that "[t]he selection of a period for the achievement of corporate goals is the responsibility of the directors," language which implicitly sanctions board use of defensive tactics such as poison pills.[108] New Jersey's code provides that the board may reject "any proposal or offer to acquire the corporation" if it determines that the offer "is not in the best interest of the corporation," and the board is not "obligat[ed] to facilitate, remove any barriers, or to refrain from impeding the proposal or offer."[109] Although most corporate codes give shareholders the authority to amend bylaws, others vest the power in the board, subject to change in the articles of incorporation. For example, the Indiana code provides that "only" the board of directors may amend or repeal the bylaws, unless the charter specifies otherwise.[110] Compare these with Alaska's unique provision which gives concurrent power to adopt, amend or repeal bylaws to the shareholders and the board, but provides that the power of either may be restricted or eliminated in the articles of incorporation.[111]

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[105] GA. CODE ANN. § 14-2-1020(c) (1994).

[106] ME. REV. STAT. ANN. tit. 13A, § 601(3) (West 1981).

[107] NEV. REV. STAT. ANN. § 78.120 (Michie 1994) (emphasis added).

[108] § 78.120(3). Ohio's code provides that "[t]he selection of a time frame for the achievement of corporate goals shall be the responsibility of the directors." OHIO REV. CODE ANN. § 1701.59(A) (Anderson 1997). However, the Nevada and Ohio codes also provide that board adopted bylaws "are subject to shareholder adopted bylaws." MBCA § 10.20 statutory comparison at 10-79.

[109] N.J. STAT. ANN. § 14A:7-7 (West 1997 Supp.). The board's discretion is bolstered by a strong "other constituency" provision. *See* § 14A:7-7(2); *supra* note 14 and accompanying text.

[110] IND. CODE ANN. § 23-1-39-1 (Michie 1995); *see also* S.D. CODIFIED LAWS § 47-2-49 (Michie 1991).

Of potentially greater significance to the anti-pill bylaw is the effect of pill authorization statutes.[112] In some states, authorization of the pill is implicit rather than explicit. For example, Colorado's provision states that "[t]he terms determined by the board may *without limitation* preclude or limit any significant shareholder from exercising, converting, transferring or receiving rights."[113] Georgia's provision, which gives the board "sole discretion" to determine share rights, has been interpreted by one court as an absolute bar to an anti-pill shareholder bylaw.[114] Whether or not courts in other states will follow suit remains to be seen. It should be noted that Georgia's statute has a significant legislative history as it was fashioned by the Legislature specifically to overcome a problem with the use of flip-in poison pills.[115]

Certainly the endorsement of pill use by the state legislature sends a strong message. However, even a pro-pill statute like New York's[116] may not signal the death knell of an anti-pill bylaw provision. Some practitioners predict that "bylaw amendments which either require shareholder approval for future anti-takeover devices or establish rules and guidelines for the company's response to outside bids" would be upheld by New York courts.[117] Their prediction is based on case law which demonstrates that "New York courts have long recognized that shareholders may adopt by-law amendments circumscribing the authority of directors on core corporate governance issues without impermissibly interfering with the board's authority" to manage the corporation.[118] A close examination of case law in conjunction with state statutory provisions will likely be required to determine the validity of an anti-pill bylaw.

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[111] ALASKA STAT. § 10.06.228 (Michie 1996).

[112] Several state corporate codes include language which indicates that the board's right to set share preferences includes poison pills. *See e.g.*, ARIZ. REV. STAT. ANN. § 10-624C (West 1996), which provides that "[t]he rights, options or warrants may include provisions that adjust the terms of the rights, options or warrants if there is an acquisition of shares, reorganization, merger, consolidation, sale of assets or other occurrence;" VA. CODE ANN. § 13.1-646 (Michie 1993), which provides that "the terms and conditions of rights, options or warrants created or issued by a corporation may include, without limitation, restrictions or conditions that preclude or limt the exercise, transfer or receipt thereof by designated persons or classes of persons or that invalidate or void such rights, options or warrants. . . ." *See also* WLR Foods, Inc. v. Tyson Foods, Inc., 861 F. Supp. 1277 (W.D. Va. 1994) (interpreting Virginia statute).

[113] COLO. REV. STAT. ANN. § 7-106-205 (West 1997) (emphasis added).

[114] *See supra* note 19.

[115] *Id.*

[116] *See supra* note 14.

IV. SUGGESTED RESPONSES TO ANTI-PILL BYLAWS

Corporations should examine their vulnerability to an anti-pill bylaw proposal and take steps now to make sure they are ready to respond to this serious measure.[119] Boards with the ability to amend bylaws should first consider maximizing advance notice requirements for shareholder proposals as well as limiting shareholders' ability to call a special meeting.[120] Unless they can be enacted by the board unilaterally, charter amendment proposals may only be of value to a company that is contemplating an initial public offering or is about to be spun off. However, the following charter amendments should be considered: (1) a provision specifically authorizing the board to deploy and maintain a pill in the board's sole discretion,[121] (2) a provision, like Harrah's,[122] requiring a supermajority vote for shareholders to amend the bylaws,[123] (3) a provision negating or eliminating shareholder ability to amend bylaws if permitted by statute,[124] and (4) a provision negating shareholder ability to take action by written consent.[125] Unless they can act unilaterally, corporate boards should encourage state legislators to adopt a pro-pill statute[126] or at least clarify that takeover defenses are in the exclusive realm of board authority. However, unless there is a significant legislative history, like in Georgia, pro-pill statutes may not win the day in courts.

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[117] *See* Seth Goodchild & Daniel J. Buzzetta, *Shareholder Rights By-Law Amendment*, N.Y.L.J., Oct. 30, 1997, at 5.

[118] *Id.* The provisions in New York's Business Corporation Law relating to board authority to manage and shareholder authority over bylaws are "essentially the same" as most other states' provisions. *Id. See* N.Y. BUSINESS CORPORATIONS LAW §§ 601(a), 701 (McKinney 1986).

[119] *See* Meredith M. Brown & Alan H. Paley, *Preparing for Possible Attempts to Take Over Your Company: A Checklist of Things to Consider*, 68 CORP. (ASPEN LAW & BUS.) ¶1.1, at 1 (Jan. 2, 1997). Of immediate concern is the possibility that a shareholder bylaw amendment will "tie the hands" of the board in a takeover contest by forcing redemption of its pill. *See* Coffee, *supra* note 20, at 606 (noting that eliminating pill would significantly reduce time in which aggressor could gain control); *see also* Brown & Regner, *supra* note 7, at 5 (stating that bidders could use bylaw to abolish pill in "one annual meeting" or "one consent solicitation").

[120] Brown & Paley, *supra* note 118, at 3. *See also* Allen M. Terrell, Jr., *Notice By-Laws and Changing the Annual Meeting Date in Delaware*, 5 NO. 5 INSIGHTS 28 (1991) (discussing advance notification bylaws); Vaaler, *supra* note 31, at 4-7 (discussing impact of advance notification on board's exercise of discretionary voting authority).

Finally, corporate boards should strive for good relations with its large shareholders in particular. The trend toward the binding anti-pill bylaw is partly due to "backlash" from the perceived imbalance of power when corporate boards "just say no." Boards lose credibility when their first communication with shareholders is in the midst of a tender offer or proxy fight.[127] If a corporate board is effectively communicating to its shareholders that it is delivering value, shareholders are more likely to defer to management and vote to keep the pill in place.

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[121] *See* Gordon, *supra* note 6, at 548-49. Such a provision could be extended to any takeover defense or response. At the least, the effectiveness of anti-takeover bylaws should be prospective only and not applicable where a takeover bid is already announced. However, these measures will not be fool-proof in a state like Minnesota where shareholders may propose articles amendments without board approval. *See supra* note 104 and accompanying text.

[122] *See supra* note 49 and accompanying text.

[123] *See* Brown & Paley, *supra* note 118, at 4; *see also* Centaur Partners, IV v. National Intergroup, Inc., 582 A.2d 923, 928 (Del. 1990) (upholding supermajority requirement to amend bylaws).

[124] *See supra* note 111.

[125] Although untested, a provision might specifically state that the authority of the board shall not be restricted in the bylaws without board approval.

[126] *See supra* note 19 and accompanying text. Healthdyne almost persuaded the Georgia legislature to require Georgia corporations to have staggered elections for directors. *See* Steven Lipin, *Healthdyne Wins Victory Over Invacare As Federal Court Upholds 'Poison Pill,'* WALL ST. J., July 14, 1997, at B5.

[127] *See* Brown & Paley, *supra* note 118, at 5.

How state legislators will respond depends largely on whether they view the anti-pill bylaw as an internal governance decision by shareholders in individual corporations or as a new threat to the existence of state corporations. Before rushing to amend their corporate codes, states should study the shareholder bylaw issue carefully.[128] As a matter of public policy, states should consider the pill's purpose — achieving the greatest shareholder value. Certainly, this is shareholders' most vital interest. For this reason, the *Fleming* court concluded that decisions regarding the pill should not be placed beyond shareholders' reach.[129] In addition, the poison pill is of primary importance when fundamental corporate changes are contemplated. The institution of a pill is not an ordinary business decision aimed at a single transaction. It is a significant corporate governance decision in which shareholders arguably have a legitimate procedural role.[130]

Adopting a pill validation law would be a simple step that legislatures could take to offer some protection to corporations' use of poison pills, while leaving in tact shareholder ability to participate in corporate governance through bylaw amendments. This approach would work to preserve the pill and the delicate balance of power between the board and the shareholders which continues to be a central feature of public corporations.

Kate Margolis

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[128] The wisdom of anti-takeover statutes passed in response to the hostile raider era has been questioned. *See supra* note 14 and accompanying text.

[129] *See* Lesser, *supra* note 25, at 511.

[130] *See supra* notes 89-97.

PANEL DISCUSSION

THE TOBACCO SETTLEMENT: PRACTICAL IMPLICATIONS AND THE FUTURE OF THE TORT LAW

INTRODUCTION

On Friday, October 24, 1997, the School of Law hosted a panel discussion titled *The Tobacco Settlement: Practical Implications and the Future of the Tort Law.* A complete transcript of the proceeding follows.

Richard Scruggs, Haley Barbour, Professor Tom Mason, and Attorney General Michael Moore comprised the panel. The discussion was moderated by the editor and publisher of the *Scott County Times*, Sid Salter. This forum was the first of its kind concerning the 1994 lawsuit initiated by Attorney General Moore on behalf of Mississippi against thirteen tobacco companies. It was a unique opportunity for students and faculty alike to listen to the key players discuss what arguably is the most significant litigation since *Roe v. Wade*.

Individual panelists were posed questions chosen by Mr. Salter, followed by in-depth discussion of each topic from the group. Several interesting exchanges took place, and at times words were heated. Attorney General Moore and Mr. Scruggs attacked the tobacco companies for advertisements targeting children and for not taking responsibility for manufacturing what they call "the only product when used correctly that will kill you." Mr. Barbour vehemently denied their accusations, and stressed it was his employer's position that American adults simply should have the right to choose whether or not to smoke. Professor Mason, known for his pragmatism, clarified several legal nuances during the discussion.

Shortly after the Law School's event, the proposed settlement went to Congress for approval. The former adversaries Moore and Barbour now sit at the same side of the table to finalize a workable plan for the future. We were proud to showcase the talent our law school has produced, and were illuminated by their insight into one of the most compelling legal and moral questions of our time.

Dean Samuel M. Davis

DEAN DAVIS: Welcome to the University of Mississippi Tobacco Settlement: Practical Implications and the Future of the Tort Law. Whether one is a critic or proponent of the tobacco settlement or indeed is indifferent, a couple of things are clear. The tobacco settlement and the process that led to it are of historic proportions. Secondly, the settlement has implications, many of them far reaching for all Americans. And there's a third point that I take great pride in pointing out. The people who were the key players in the settlement, the people who were on the cutting edge of one of the most exciting and profound developments in health care law today, are Mississippians and Mississippians who are graduates of the University of Mississippi School of Law. But you'll hear more about that shortly.

It is my pleasure to turn the program over at this point to a member of the Law School Speaker's Bureau. Robert Wilkins is a second-year law student from Jackson, Mississippi and is a member of the Speaker's Bureau. Let me just say at this point that the idea for today's program was entirely conceived by the Speaker's Bureau. Robert came to me in early or mid-September with the concept, which I wholeheartedly endorsed. It was Robert, with a little help from some others, who has really carried the load in putting this program together. Without further delay, I present to you Robert Wilkins, who will introduce our panelists and our moderator.

ROBERT WILKINS: Thank you, Dean Davis. My name is Robert Wilkins, and on behalf of the University of Mississippi School of Law Speaker's Bureau, I'd like to welcome all students, faculty, and guests. The Speaker's Bureau is extremely excited about today's presentation of The Tobacco Settlement: Practical Implications and the Future of Tort Law. We've assembled an outstanding panel which represents a good portion of the major players in this historic settlement. I know that everyone is anxious to hear the insights which our panelists have to offer about this provocative topic, so I'd like to introduce the participants at this time.

Our first panelist is a native of Yazoo City. In 1973, Mr. Haley Barbour received his law degree from Ole Miss. Mr. Barbour serves on the board of directors for several companies and has been active in the Republican Party on many levels. From 1993 to 1997, he served two terms as Chairman of the Republican National Committee. Under Mr. Barbour's orchestration, Republicans won the greatest mid-term majority sweep of the twentieth century when the GOP controlled both Houses of Congress for the first time in forty years. Mr. Barbour is currently with the law firm of Barbour, Griffith, and Rogers in Washington D.C. and is a lobbyist for the Tobacco Industry. Please welcome Mr. Haley Barbour.

Our second panelist is a native of Pascagoula. Mr. Dickie Scruggs received his undergraduate degree from Ole Miss in 1969, and then served as a fire pilot for the United States Navy for five years. In 1974, Mr. Scruggs returned to Oxford to eventually earn his law degree in 1977. He was one of only four Mississippians that served as a fellow of the International Cabinet of Trial Lawyers and was recently honored as the Mississippi Citizen of the Year by the March of Dimes. At present, Mr. Scruggs both represents and serves as lead negotiator for Mississippi and thirty other states engaged in lawsuits with the tobacco industry. Please welcome Mr. Dickie Scruggs.

Our next panelist is originally from Duncan, Oklahoma. Professor Tom Mason received his juris doctorate from the University of Oklahoma in 1962. He practiced law there until 1973 when he joined the faculty here at the law school. Professor Mason teaches classes in torts, oil and gas law, and federal trial practice. His acerbic wit and practical teaching style have made him a popular professor with students in the past and present. In addition to teaching, Professor Mason directs the law school's public service and internships, and he lectures national continuing legal and judicial educational seminars. Please welcome Professor Tom Mason.

Well, anyone who has recently picked up a copy of the Washington Post or watched CNN should have no trouble recognizing our final panelist. Mike Moore is currently serving in his third term as Attorney General for the state. In 1992, General Moore became the only resident Mississippian to be selected as one of the ten outstanding Americans by the National Jaycees. Under his leadership three years ago, Mississippi was the first state to file a lawsuit against the tobacco companies to recover medical expenses in treating tobacco-related illnesses. For his efforts, he was awarded the American Medical Association's highest honor, the Dr. Nathan Davis Award. Please welcome the Attorney General of the State of Mississippi, Mr. Mike Moore.

Our moderator for tonight's discussion is Mr. Sid Salter. Mr. Salter is a graduate of Mississippi State where he was a John C. Stennis scholar of political science. He is currently the editor and publisher of both *The Scott County Times* and *The Times Plus*. Mr. Salter's syndicated political column appears in sixty-two Mississippi newspapers, and his television commentary, "A Capital Idea," airs weekly on Meridian's ABC affiliate. Last fall he was chosen as the inaugural Kelly Gene Cook Chair in Journalism here at Ole Miss where he also served as assistant professor. I would like now to turn the program over to the moderator of The Tobacco Settlement:

Practical Implications and the Future of the Tort Law, Mr. Sid Salter.

MR. SALTER: I must say Robert, it was a great deal easier to find a parking place on Friday of last year when I was on the faculty and when the Rebels were losing. And I'd be remiss if Haley Barbour and I didn't pause a moment to remind you that most of you Ole Miss folks thought it was pretty funny when the SEC came up with that artificial noisemaker ban. So this week, as you find something else to do with your sticks, we will remember you in spirit.

In preparation of today's exercise, I decided that perhaps the best preparation I could make would be to watch television. So I flipped over to the Discovery Channel, and they had a program featuring crocodiles eating their young which I thought would be most appropriate and an excellent preparation for today. We have an outstanding panel. There are news folks all over the United States that would kill to have this group of people on a panel to address these questions. You are most fortunate. Your fellow students did a good job. So let's dive right in.

I direct the first question to Attorney General Moore, and as I told the gentlemen earlier, this is what we refer to in journalism as a "big softball." Mr. Moore, define for us the tobacco settlement both nationally and in Mississippi, both in terms of what it is and what it isn't.

MR. MOORE: Thank you, Sid. It is good to be here, and of course, Dick and Haley and I are very proud that Ole Miss is the one that's leading this project as we are all graduates of this school. And actually the idea for this lawsuit came from a fellow by the name of Mike Lewis who was also in the very same class and is here today on the front row with his wife, and many on our trial team are here.

The national settlement and the Mississippi settlement are a little bit different. We filed this litigation about three and a half years ago. We think it's the most important public health litigation ever filed in this country. We think, frankly, it will save more lives as a result of this litigation than anything that's ever been done before. The Mississippi settlement, as most of you know, is a financial settlement primarily. It's a $3.5 billion settlement. The first $170 million is in the bank down in Pascagoula, Mississippi now. Actually news for you, Sid, we just got another $62 million that was deposited in a Hancock Bank in Gulfport Monday and that will be used to develop a pilot program to reduce teenage smoking in Mississippi. We've got to spend the money in two years, $62 million, and we will be the model for the rest of the country. So that's an addition and a plus. And, frankly, that's what the case was about in the first place, to try to help kids refrain from smoking.

The national settlement that Dick and I worked so hard on with the help of many others across this country is the $368.5 billion, and we had to learn to say "B", Haley. We were saying million for a while, but $368.5 billion settlement that the industry will pay over a period of twenty-five years, approximately $15 billion a year. The money will be used for various things. Part of it will be used to help reduce teenage smoking across America with a $5 million a year counter-marketing campaign. We're going to get rid of all the tobacco companies' advertisements. So, basically, they won't be able to send the "do smoke" message anymore and we will, in turn, turn on a very loud "don't smoke" message. There will be a cessation program to help people in this country who can't stop smoking get aid to stop smoking. There will be money for FDA and other government agencies to have all kinds of programs to help people. So, frankly, we think the results of it will be a healthier America, and frankly we think again we'll save more lives from this litigation and this settlement than anything that's ever been done in the history of this country and maybe the world. We're very proud of it.

MR. SALTER: Professor Mason, your take on defining the settlement.

MR. MASON: Well, it's just remarkable. These guys took a lawsuit that had virtually no chance of winning to $368 billion. I do have an inquiry for Mike though. Mike, you represent that the industry is going to pay for this. But as I read the material, the industry is going to pass the cost of this to the users of tobacco. So we're going to be paying for it.

MR. MOORE: Well, actually the first $10 billion, the upfront payment, as we called to be paid immediately upon the signing of the document, just like in our case our particular shares 1.7% of that $10 billion. So it's $170 million. That comes straight from the coffers of the tobacco industry. After that, we made it mandatory in our settlement that the tobacco company has to raise their price in an amount that would cost $15 million or raise $15 million a year. We did it for a reason. The reason we did it is because, as the price of cigarettes goes up, the higher it gets, the little kids stop smoking. The number one way to keep kids away from cigarettes is to have it cost more. So, frankly, there were some health benefits in it. But truthfully, you'll be helping to pay for it, and we appreciate it.

MR. MASON: Well there are those who may not entirely appreciate what you did.

MR. SALTER: But from the viewpoint of one who does, Mr. Scruggs, your help in defining the tobacco settlement.

MR. SCRUGGS: Well, the principal strategy in the tobacco litigation, four years ago and in trying to crash this national revolution of that litigation, was to do something about the enormous public health crises that smoking has brought about. For those of you who have not kept up with this issue, over 400,000 Americans alone die prematurely every year from tobacco. Over three thousand kids, that's people under age eighteen, start smoking every day. One thousand of those three thousand will ultimately die prematurely from a tobacco-related illness. The death total from tobacco is the equivalent roughly of a jumbo jet crashing every day. Something had to be done about it. And the strategy that we embarked on in crashing this settlement was one aimed at kids because the studies all show that if you don't start smoking regularly as a kid, before you're eighteen, the chances are greatly reduced that you ever will start smoking. About eighty percent start before their eighteenth birthday. So everything we've done is aimed at stopping kids from starting to smoke. It's not aimed principally at adults who make the choice to smoke. Mike touched on one of the counter-measures that the agreement calls for, and that is drastically increasing the price of cigarettes because it has a disproportionate increase on the youth market when cigarette prices go up. A fifteen-year-old doesn't have as much disposable income as someone who is older, twenty-four or twenty-five years old, and has a job. There are all sorts of other account measures in the settlement including a $500 million per year media-based counter-marketing campaign aimed at kids. It's to enable the public health community to resort to some sort of campaign to demoralize smoking, to make it look less glamorous, and to basically discourage kids from taking it up. That's the hallmark of the settlement. Everything is aimed at stopping kids from starting to smoke and ultimately remedying this enormous public health problem we have in this country.

MR. BARBOUR: Sid, if I can just pick up from there. In February of this year when the five largest tobacco companies who do business in the United States, four American companies and one British company, came to me and asked me to represent them on the legislative side of this issue, they had already made the decision that they wanted to have a comprehensive negotiated resolution of these issues.

The companies understood and understand that it is incumbent on them to do everything they can do to try to prevent, reduce, and aggressively attack under-age use of tobacco products. Bill Novelli, who is the president of the campaign for tobacco-free kids, made the remark very early in the negotiations that the tobacco companies had agreed, and I think Mike and Dickie will tell you often, to do more to attack, reduce, and prevent youth smoking than any responsible group had proposed in the last ten years. The companies made the decision that it was right and in their interest to try to attack, reduce, and prevent youth smoking. But in doing so, to protect the rights of adults who choose to smoke. More than forty million adults in America choose to smoke. And it is a crucial interest to the companies in these negotiations that while attacking youth smoking, we protect the rights of adults who choose to smoke and for them to legally obtain traditional tobacco products in a peaceful marketplace. The companies, as I said earlier, have agreed to do essentially everything any responsible group has proposed. Furthermore, the companies have agreed to pay $368.5 billion, a phenomenal number, an almost-hard-to-fathom number.

As some of you may know, this is in excess of the total profits of companies over a twenty-five year period. But as Mike Moore said, the anti-smoking groups insisted that all the costs be passed along as an anti-smoking provision. The companies also agreed to voluntarily give up their constitutional rights in terms of advertising and marketing as part of the settlement. But let me emphasize, while the companies' first two interests are to protect the rights of adults who choose to smoke and to be sure adults can legally obtain traditional tobacco in a peaceful marketplace, their third interest is if they pay for a settlement that they get a settlement. And that is one of the things that's very important, that we bring this to a conclusion which will be done by Congress that what ultimately passes is what the companies that agreed to the Attorney General's proposed resolution signed on June 20th. There's a lot in there the companies don't like, but they've agreed to it. They are keeping their word in supporting it, but in the end, they will insist that if they voluntarily give up their rights that it will be in return for a settlement. And that's where the resolution is today.

MR. SALTER: Students, before we get into the next round of questions, I think it's important to define some of the interrelationships here. We discussed this in the office before we came out. Haley Barbour is one of the true architects of American politics. He did help build the 1993-94 Republican surge. In my opinion, he is one of the brightest political minds in the country. He's from Mississippi, and he's an Ole Miss graduate. He is directly responsible, in my mind, for helping Trent Lott rise to the position of Senate Majority Leader. He also was of some help to Newt Gingrich in obtaining his position. He is also just one of the works in the vineyards in the Republicanism in Mississippi.

Dickie Scruggs is Trent Lott's brother-in-law. He is also Attorney General Moore's largest recorded political contributor, a fraternity brother, and they're friends too. Now that we have all that out on top of the table, Tom Mason taught these guys. So we're not talking about tobacco guys. We're talking about incest here. All of that said, now that those demons have been exorcised, let us get to the questions. Mr. Moore, you've been subjected to no small amount of criticism both in Mississippi and nationally for the task that you took on with the assistance of some of these gentlemen. Whether you agree with the philosophy or not, you've done an admirable job. But let's talk about some of the thorny issues. The fees to Mr. Scruggs and the rest of the battery of outside attorneys that have assisted the State of Mississippi in this effort. How much were those fees? How was the fee structure decided? Given Mr. Scruggs' status as one of your major political contributors, has this case been handled ethically on the part of the State of Mississippi?

MR. MOORE: Well, first it's been handled successfully on the part of the State of Mississippi. We have a $3.5 billion settlement in what Governor Fordice and many other Mississippians, who were critics at the time, said was a case that we didn't have any chance at all to win. Now, four years later you fast forward, and we've been successful with a $368.5 billion national settlement in the wings and, of course, now criticism comes. Dick is my friend, and frankly, when I started looking around this state to put together a trial team to take on the most powerful industry in the world, I didn't look for my enemies. Frankly, I looked for my friends. The fellow who first bought the idea is a fellow, raise your hand, Mike, Mike Lewis. And Mike came to me with the idea for this lawsuit. When Mike and I discussed it, we felt like what we needed was somebody who wouldn't back down, somebody who had the resources, the money to fund a case like this, and somebody who had the smarts and the determination to take it on.

So I put together a team of Dick and, actually there are about twelve Mississippi law firms involved in this case, a South Carolina law firm, some Harvard law professors, and others. We had a huge team, and then Sid, we went all over the country and got forty other states involved. Frankly, Dick, they didn't give up quite so easily. It was a little fight for four years the way I remember this. And it wasn't the tobacco companies coming forward saying, "We'll just give you anything you want." It was one hell of a fight, let me tell you, for four years. Dickie is a financial contributor of mine. A lot of the friends that I have in Mississippi have been financial contributors of mine. But, frankly, I don't think it had anything to do with it whatsoever.

As far as finances are concerned, I think that we ought to have some campaign finance reforms in Mississippi. I don't think anybody ought to take over five hundred bucks, and I think that everybody ought to record every single penny that anybody gives them. Now that's my stand on campaign finance reform.

Truthfully, the argument about lawyers' fees and how much lawyers are going to make is frankly something we thought we took care of when we first filed the lawsuit. I'm the only one who doesn't have a contingency fee contract. What I did was, and you want to talk about risk, you tell me the lawyers in this audience right here that would take this deal. Here's the deal, I need you to sue the tobacco companies for me, and you are going to have to pay all the expenses and it may be as much as $10 or $12 million, and you have very little chance of winning. Nobody's ever collected a penny before, and it's going to get tough. And they're going to sue you. It's going to get horrible. Are you in or are you out? Well, the only person that I could find in the state to do it, the only team was the team that I had. And, frankly, I'm very proud of them.

We set up a schedule in our settlement so that the judge would be the one who awarded the attorneys' fees outside of any judgment that the State of Mississippi got. And the court would award how much the attorneys got. And the settlement, the same thing. We have a set of three independent arbitrators, one selected by the state, and the lawyers, one selected by the tobacco companies and one selected by both sides. Those three people will decide how much the lawyers make. The good news for Mississippi is that none of the money will come out of Mississippi's money, and on the national settlement, as Haley knows, none of the money will come out of the taxpayers' $368.5 billion. It will be an additional punishment and actually raise the price of cigarettes even more. So I hope they make a huge amount of money and the reason I hope they make a huge amount of money is because tobacco companies will have to pay it. They'll raise the price of cigarettes even higher, and fewer kids will smoke and we will win again. So I'm very proud of how we tackled this thing.

MR. SALTER: Professor Mason, on the question of ethics.

PROFESSOR MASON: I don't think there's any question of ethics. Great lawyers who went out there and did an outstanding job. I don't see anything at all that we have here. I was commenting back in the office a moment ago a part of the consideration in entering into a contingency fee is the risk that is being taken and the commitment being made. And as I would view this lawsuit when they began the lawsuit, they had a risk of, like, ninety-five percent against them winning. Of course, they didn't have a win; they just settled. But at any rate, at that point it was a terribly risky thing for any lawyer to undertake, to commit both money and time to.

MR. SALTER: Mr. Scruggs, when Mr. Moore is criticized in national publications, your name is normally in the next paragraph. Since you have become a poster boy for high legal fees in the tobacco settlement, talk to us about the fee arrangements. Do you feel like you have treated your fellow taxpayers in Mississippi ethically in this situation?

MR. SCRUGGS: Well, first of all, Mike has rarely been criticized in the national media. He's collected many accolades, and I've been lucky enough to be part of the team.

There have been questions about attorneys' fees, and quite frankly from our experience in the asbestos litigation for the state well before the tobacco litigation, we knew that our enemies, especially the tobacco industries, would use the attorneys' fee issue as a distraction to detract and distract the public from what the real issues in the lawsuit were. So that's why the lawyers on our legal team agreed to take this case without any sort of contract or agreement from Mike Moore or the State of Mississippi other than a pledge by Mike that if we are successful in the lawsuit, that he would ask the judge in the case to award attorneys' fees from the tobacco industries. Now bear in mind, we have no contract, no contingency fee arrangement, no nothing. We took this on because most of us on our trial team had been successful in other litigations. We felt like it was our public duty in a way to sort of re-invest some of the money we had made in asbestos litigations and other litigations that had been lucrative for us, to invest it back in public health and do the right thing.

This was a litigation that cried out for somebody to take it on, who was willing to take a chance, and we took a chance. Mike didn't pick me because I contributed money to his campaign. Mike took the biggest political risk of any politician in America. In fact, Mike Lewis remembers the day before this lawsuit was filed. We sat in Mike's office and said, "Mike, this is not a politically smart thing for you to do. People are going to think it's a frivolous lawsuit. They're going to agree that smoking is bad, but they are not going to somehow translate that into the fact that the tobacco industries ought to pay money. They are going to pour all sorts of political resources into defeating you, and this is not a smart political move."

And Mike's response to us was, "Well I'm the Attorney General. This is a public health problem. I'm supposed to protect public health, and we're going to do this if you're willing to do it." We said we're willing to do it, and we're going to do it based on a handshake and the agreement that I just told you about. Not a penny of this money was ever intended to have come from the State of Mississippi or money that could have come from the State of Mississippi, and that's the way it's turned out. We've been successful. It's sort of a loser-pay philosophy—they have agreed to pay this sum and business activities as Haley just pointed out, and I think that the reward that we've gotten so far just knowing we've made a big difference in public health has been worth any legal fee that we could have ever hoped to achieve.

MR. BARBOUR: Sid, the question was "Is this ethical?", which is the question he's going to have to answer. From the companies' point of view, the companies took the position that they were willing, as the Attorney General said, for there to be set up a commission, if you will, to set the attorneys' fees and that they would pay whatever the commission decided was fair and equitable. This problem is not a problem among these parties. This problem is part of a problem of Congress. When some of the people, I believe it was part of your team, Mike, when the Florida settlement was reached, the attorneys for the state manufacturers demanded attorneys' fees first in excess of $1 billion and then near or in excess of $2 billion. And I think Congress is very cognizant of the fact that you can say where the money does or doesn't come from, but there is a pile of money. There is a universe of money. It is not limitless. And several in Congress have made the point that they are determined that the money that the companies pay, $368.5 billion or whatever it turns out to be, that money be spent for public health, particularly children's health care programs. Because while Congress wasn't a party to this agreement, they will write whatever law they want to, and the negotiators understood it that Congress would ultimately.

I think that it would be unfair to the law students without making plain that while the companies had agreed to pay attorneys' fees, and the protocol outside the settlement that Congress is very focused on the issue of where the money goes. If there are many who say when Florida lawyers demanded $2 billion in attorneys' fees, there are a lot of people in Congress who think most of that $2 billion ought to be going to Florida, to taxpayers in Florida, to public health in Florida, to children. And so, it's not fair for us to delude the audience just because the companies and the Attorney General are willing to agree to it that means everything.

MIKE MOORE: Let me clear one point up. Florida attorneys are twelve different—Florida had a settlement right after the Mississippi settlement. And the Florida team is composed of twelve different law firms. Two of the law firms working with us were involved in that litigation. Four of those law firms down in Florida decided—they had a twenty-five percent contingency fee contract down there—and they settled their case for about $11 billion, but they're a little larger than Mississippi. But four of the lawyers the night of the settlement decided, or all twelve decided, they were all going to go along with getting their money out of the pool, waiting on an independent panel to do it. The next day they decided that maybe they had made a mistake, four of them did, and they decided, "Well let's see, twenty-five percent of $11 billion. That's about $2.5 billion. That's a big chunk of money."

So they decided they wanted to make a demand on the State of Florida for the money. So they're all warring and fighting down in Florida, and God bless them. But my eleven law firms or twelve firms here in Mississippi, every single one of them, has signed and agreed to the Mississippi settlement alone that all of these lawyers will get paid from an independent panel. If it's a national settlement, they will get paid from an independent panel. Frankly that's the responsible and efficient way for the lawyers to behave. Now the truth of the matter is the risk is, and we talked about this today, I mean, who knows who's going to be on that panel? They may decide—that independent panel may decide—to award $50 million dollars nationwide for what, gosh, one thousand to fifteen hundred lawyers. There's going to be some awfully disappointed folks.

MR. SCRUGGS: I know it is.

MR. SALTER: While we are on the subject, I'd like to ask Mr. Moore and Mr. Scruggs, particularly, the so-called Gastono Class Action Group, how does that factor into what happens in Mississippi?

MR. MOORE: Well, it really doesn't. We had—speaking of brothers-in-law, we had the President's brother-in-law involved in this too. A fellow by the name of Hugh Rodham, who is Hillary's brother, was involved in the table too. The committee often kids us a little bit and says this is the brother-in-law deal. We've got Clinton on one side, and we've got the President's brother-in-law on the other side. We had a lot of cackles about that during negotiation. Hugh Rodham was part of the Gastono litigation, which was a major class action filed by sixty of probably the richest law firms in America. The class action didn't get certified. It got certified and got overturned, so it wasn't successful, but they helped negotiate the bill because they represented the class action all over America. So they'll be involved, Sid, when it's all said and done. The piece that they probably contributed the most to was their interpretation about conditions. So what they contributed to is the cessation programs and the medical monitoring others propose who might have some addictive behavior in the future.

MR. SALTER: Will their things pass through Mississippi's money?

MIKE MOORE: No. They don't get anything out of Mississippi at all. I mean, it's a Mississippi settlement. That's all that's done. There's no national settlement. The lawyers will get money. But in the national settlement, they can make application to the national panel of three folks and get money from them in whatever amount that the independent panel says that their work is worth. I mean, that's the way it's going to be. It's a risk.

MR. SCRUGGS: Let me just add this. The reason the tobacco industries agreed to these revolutionary changes is not out of powers of persuasion. We litigated these guys. The Attorneys' General lawsuits, now forty-one or forty-two around the country, the class action lawsuits like the Gastono lawsuit and others are what put the tobacco industry in the position where they could agree to these changes. I think they made a smart business move to agree to reform their practices, but make no mistake, it was the litigation that made them do it. So the Gastono lawyers, the Gastono class action, played a role in bringing tobacco industry to the table in a global sense. But it played no role in Mississippi, and it will not play any role.

MR. SALTER: Mr. Barbour, *Time* reported earlier this year that, in your role as a lobbyist for the tobacco companies, you attempted to use your influence with Majority Leader Lott and with House Speaker Gingrich to insert legislation that would make the settlement in favor of the tobacco companies tax deductible. If the government is going to continue to subsidize the growth and production of tobacco, and if as you advocated apparently at one point as Mr. Lott and Mr. Gingrich agree to that settlement, fees should be deductible. Why shouldn't John Q. Public look at the entire settlement debate as sort of a government-sponsored lawyer game of three?

MR. BARBOUR: Sid, what *Time* and some others wrote is that Congress, in the budget, included a provision that made payment of the new increase in federal excise tax on cigarettes a tax credit, which is incorrect. It only applies to cigarettes; it doesn't apply to smokeless tobacco. Congress raised the tax on cigarettes ten cents a pack and then in three years another five cents a pack, which over the life of twenty-five years is about $50 billion.

Time said Congress slipped into the budget that this would be a tax credit, which is not the truth on either of two facts. It was not slipped into the budget. The President's Chief of Staff, Erskine Bowles, the President's Head of White House Legislative Office, John Hilly, the President's Head of the Office of Management and Budget, Frank Raines, and the President's Secretary of Treasury, Bob Rubin, all agreed that this should be credited against $368.5 billion, not a tax credit where you got a tax credit off your federal taxes. But if there ever was a comprehensive resolution that the $50 billion of new taxes would count against the total of $368 billion in taxes, Dickie and Mike and all the Attorneys General didn't like that. But it's not a tax credit, never was a tax credit, nor was it slipped into the bill. Federal taxes are tax deductible for every industry in America in every business. If you pay a federal excise tax on a product, it's tax deductible forever. That was never an issue. That's automatically the case. The government doesn't say, "Tom, you get to sell something for a dollar, and we're going to take twenty cents out as a sales tax. But by the way, you've got to pay income tax on the sales tax." That's not the law for any industry. It was never considered to be the law here. The issue is whether or not Congress should say, when we pass a bill since this $50 billion of taxes was passed after the agreement was reached, should we credit. The initial decision agreed to by the White House was, yes, it ought to be credited against the $368 billion if you ever have a deal. Subsequently, a lot of people complained about that. Congress took it out and said, we'll just leave it as an open issue but never a tax credit. And the idea that slipped in; this administration affirmatively, positively, and personally agreed, yeah that's what we ought to do.

MR. MOORE: I—

MR. SALTER: One second, Mike. I think you deserve the chance to come home in front of the home folks and defend that *Time* allegation, and I think you did. But more to the point of the last part of the question. Don't you see this as government with their hand out on this side saying, "Well, tax companies, give us some money for the products you're putting out on the marketplace." And then out of this hand saying, "Here's some money, tobacco growers. Go grow some more of it." Explain how the taxpayers should perceive that.

MR. BARBOUR: As it relates to this agreement, as the Attorney General said, the public health people who insisted that every penny be passed along, they want to push up the price. Tom and the other forty something million adults who use tobacco products don't like that. But that's what the public health people want. From the companies' point of view, they simply wanted to make sure that if one company passed it on, everybody passed it on. They did not want any company to get a competitive advantage. That is, if a very big wealthy company could say, "Hey, add a sixty-five cents tax; we'll pass on forty-five. We'll run everybody else out of business. We'll create a monopoly." Well, so that's why you must pass through. Everybody must pass through, and it's not because anybody's subsidizing tobacco. I can assure you these guys didn't do it because they wanted to help the tobacco industry, they did it because they wanted to attack smoking. We want to protect the rights of adults who choose to smoke, but understand that that is a price that's going to have to be paid in order to—

MIKE MOORE: Pardon me. The problem, though, is of course, they just got a client to defend here. But let me lay out to you what the situation was. We sit in the room with the tobacco companies for a hundred days. We've been fighting them—Dick and I—for four years, and we negotiate a settlement, $368.5 billion, and we squeezed every single penny out of them we thought we could get. Well, then it's only two or three weeks later, and we read the newspapers. These suckers slipped in there and are going to take fifty billion of our dollars away. What they don't tell you is that for about a year, Senator Hatch and Senator Kennedy were trying to get a forty-cent tax placed on tobacco to fund ten million kids in

America who don't have health insurance, who can't go to the doctor.

The tobacco companies, through their lobbyists, beat them back and beat them back and finally had to give in to a fifteen-cent tax, which is what they got there, which we wanted another additional tax upon children's health care. But then we ended up in this particular scenario giving it back. What we got upset about is the next week when I go to lobby for the national settlement, they say, "You can't trust the tobacco companies, Mike. Look what they did just the other day. They sneaked $50 billion back." So it's been one of the biggest hurdles that we've had to get over now. We just have a disagreement about that. We think it was a dumb move on the part of the tobacco companies.

MR. SALTER: Professor Mason, how about you shed a little light on that question.

MR. MASON: I can't shed light on what these gentlemen have been talking about. I don't know anything about it. But you asked about the ambivalence of the public and see that money kept going out of this hand and coming in from the other hand, I just share that ambivalence.

It's not only at the federal level where they're paying the tobacco farmers a subsidy and also accepting money from the tobacco industry for the settlement. At the state level, we have substantial state income taxes and excise taxes—not income taxes—but sales tax collected on the tobacco industry, and we turn around and say, "Here's the money back." So it's a little bit hard to see a lawful product being held responsible for whatever effect it has on the public.

MR. SALTER: Mr. Scruggs, let me rephrase the question. Is government behaving in a schizophrenic manner on this issue?

MR. SCRUGGS: Probably so, but a little-known fact is that the tobacco subsidy which keeps the price of tobacco artificially high actually keeps the price of American tobacco artificially high. There are also requirements that the tobacco industry buy a certain percentage of all their tobacco from American growers. By keeping the price higher, it makes the cigarette price higher, which discourages consumption. So if you completely eliminated the tobacco subsidy—it's not truly a subsidy, but let's call it one. If it was completely eliminated, it would make cigarette prices go down and make consumption go up and make it easier for kids to buy. Now the reason for the subsidy is not that reason, but that is one of paradoxes of the tobacco issue.

It is an enormously complex social and economic issue, and you've just hit the tip of the iceberg. One of the things that Tom Mason said, if I might respond to it, is how can we sue an industry that sells legal products and indeed one that we tax, and that we derive a considerable amount of sales and excise tax from? The fact of the matter is that there's a big difference between being a legal product and a defective product, and all of you law students should understand that. Asbestos is a legal product. It's not sold illegal. It's taxed, but it's a defective product. That's what makes it subject to being sued on.

The fact that tobacco industry paid sales and excise taxes, well taxes are not a damage deposit. Just by taxes, you don't get to simply take off whatever damage you cause society or the victim from the amount of the damage. You can't deduct taxes. You couldn't have gone down to the courthouse and broke the windows out down there and the district attorney sued you for damages. You can't say, "Well, I pay more of that in city taxes, so just take it off my taxes." It doesn't work that way. If it did, the companies who sold products who are subject to excise taxes—cosmetics, for example, who are subject to excise taxes—would be entitled to a tax refund because they don't kill people. They don't cause an enormous public health threat like the tobacco industry does. So it's not a logical argument to say because you tax it or because it's legal, you can't sue somebody.

MR. BARBOUR: Can I just, Sid, make a point about that? Again Professor Mason makes a point that's on the minds of American people, and it's also on the mind of Congress. As I said, my clients, the five tobacco companies I represent, voluntarily entered into these negotiations. Now this is a negotiation which they gave up stuff they didn't think they ought to have to give up. I'm sure Dickie and them gave up stuff they didn't think they ought to have to give up. So this is all mutually agreed to. But again Congress has got past this, and Congress is grabbing at what you're talking about. This is—Dickie I think referred to—unprecedented landmark legislation. Howard Baker says it is on a scale of the 1964 Civil Rights Act. Of course, widely different subject matter, but in fact in some ways much more complicated. Setting the precedent of punitive action against a legal product doesn't set well with a lot of people in Congress. In fact, eighty percent of Americans think adults should have the right to choose to smoke, and seventy-five percent of Americans think that adults who choose to smoke ought to be responsible for the health consequences of smoking. So Congress has got some problem with that. Mike mentioned that the Attorneys General in this agreement have in there how this money will be spent. As he knows, the companies take the position that it's none of their business how the money is spent. We're willing to pay. We're not going to try to say how the money is spent. But interestingly, it would be the Republicans who Congress tends to agree with more than the Democratic Attorney General that they want the money to be set by states. They don't want any new entitlement created by this. They do want more money spent for public health, and they are very concerned about attorneys' fees. But they are very concerned about the legal precedent about an industry, even by consent, giving up its First Amendment right. You know, it is by consent, but it's not exactly—it's with coercion. Finally, I think all of us have to understand tobacco is not the only problem American youth faces.

MR. SALTER: And that's a good segue into our last question before we open it up for the students. I'm going to direct this question to Professor Mason. As Mr. Barbour indicated in his last response, tobacco is not the only product that causes problems in society. While sports cars, marvel beef steaks, I'm talking about mine and the nation's problem. Where does it end? What is the future of torts as this symposium is entitled? Where does this type litigation end?

MR. MASON: Well, I don't think this litigation changes anything. If it changes anything, it's going to make plaintiffs' attorneys more willing to take chances and be more innovative in the approaches that they take in lawsuits. But this was a settlement. It did not make any law. The law which preexisted, the fighting of this case, was all against the state. The state had no right of action to bring this lawsuit in its own right. The only right thing in it was derivity from the people who receive the medical care. I don't think that the state in the traditional sense of production can prove causation. They would have a very difficult time proving that any patient in a Medicaid program suffered a condition from tobacco, and more particularly that any patient suffered such a condition as a result of smoking a particular company's tobacco. So they're going to have to make new law all the way through. They are going to have to go to the Supreme Court of this state and get the Court to accept the state's right to bring this action, and then get the Court to approve much looser ways of proving causation. This is very problematic. That's not changed. This lawsuit is so unique I don't think it changes anything referring to individuals who are injured by a product and who bring their own particular action.

MR. SALTER: Mike.

MR. MOORE: Well, you know, one of the most important things that we've done—and I'm really proud of our state because Mississippi almost became the sanctuary for the truth. I mean, when we filed our lawsuit, one of the main things that we wanted to do was to get the truth out of the industry. And if you will remember the Bryan Williams documents, which frankly probably broke open this thing. That guy comes to Mississippi and brings those documents. Dick and I—we get them out all over the world and take them to the Justice Department so that through the litigation the truth gets out. Jeffrey Wygand, the famous vice-president of Bryan Williams and head of research there, where does he come and give his deposition? He comes to Mississippi because every other court in America had enjoined him. So one of the real hurdles of litigation when you file a lawsuit of this magnitude is, and I hope it's always this way, is that the courtroom, through litigation, is always going to be a search for the truth. And, frankly, you know I hear what Professor Mason is saying, but I don't believe the tobacco company would pay us $3.5 billion if they thought we were going to lose our lawsuit. I don't think they entered into a $368.5 billion settlement because they thought we were going to lose. They thought they were going to win some, and they thought they were going to lose some. They thought some courts would go with us and some courts would go with them. But we were pretty smart, I think, in retrospect. What we did was we built as big an army with as much resources as the tobacco industry had, and we got to that point which I think was probably around twenty or twenty-five states. That's when we—Dick and I—began to hear from the tobacco industries somewhere around January or February that they were interested in working something out. We were surprised as anybody when on April 3rd, we shook hands with Jeffrey Bower and Steve Gullstone and looked them in the eye, and they said they wanted to change the way they do business. That was the other thing that we wanted to accomplish is to make this industry who has made a product that, yes, people chose to smoke but didn't know the real truth about it—make them change the way they do business and may be one of the strongest things lawyers in this country can do. You talk about civil rights. We didn't get the 1964 Civil Rights Act passed because Congress decided it would be a good law. We got it passed because lawyers risked their lives in courtrooms, and people risked their lives all over this country to push for and use their leverage to get it done. I would say it's a good comparison.

MR. SALTER: Dickie, let me go to you directly. Do you perceive a time when a lawyer with your skills and your resources would say, "Hey, a lot of people are dying because they can't be responsible consumers of alcohol. I'm going to do something about this on behalf of the people of my state." Do you see that happening?

MR. SCRUGGS: Well, first of all, let me say this. Tobacco is a unique property. There's not anything else like it sold legally in this country. It's the only product sold to consumers that, if used exactly as directed, will kill you or make you sick. Alcohol has to be abused. All these fatty foods and things like that have to be abused before they are dangerous, and even when abused do not create anywhere near the public health problems that tobacco reeks on us. As Haley said, forty million Americans smoke. About half of them are going to die prematurely from diseases that are caused by smoking.

The Mississippi case was not a tort case. It took us months of brainstorming to come up with a legal theory that fit this industry. It's not a tort case. We didn't sue on behalf of individual smokers where we would be stuck to subrogation to the defenses who were against the smoker. And the reason for that and the reason tort law didn't fit is because traditional tort law is designed to address a balance between the consumer and the manufacturer. Those of you law students know what 402A is, ordinary negligence principles or breach of warning principles are all based on relationships between the consumer and manufacturer. But in the tobacco situation, neither the consumer nor the manufacturer were paying for the cost of the enterprise. Those costs were being externalized to the taxpayer in the form of health care in Medicaid and indigent health care. In Mississippi, one Mississippian in five, twenty percent of all Mississippians depend on the government for their health care. It's an enormous burden on taxpayers. In effect, it was a transfer of cost from the tobacco industry to the taxpayers. Seventy-five percent of them don't smoke. It was simply an externalization of the costs for the enterprise that was being unfairly forced on the taxpayer. So we didn't sue in tort under products liability theories. We sued on equitable theories, and those of you who are in law school here know that equity is sort of a safety net. None of those other legal theories fit, but they're still out there. Equity won't allow a law without a remedy. There are traditional equitable remedies, and we ultimately settled on three or four of them. Public nuisance is one of them, and you might want to look that up if you're interested; restitution and indemnity; unjust enrichment. All of those legal theories have been around for centuries, and we used those theories. We didn't go on traditional tort theories, and it takes a real orientation here in thinking. We are all used to thinking in terms of tort law. This was not a tort case.

MR. SALTER: Haley.

MR. BARBOUR: I just want to make two or three points because I know that you're going to throw your shoe at me when the clock hits six o'clock. One is that the tobacco companies didn't enter these negotiations just because of litigation. As I said from the beginning, they wanted a comprehensive resolution on a whole number of issues: regulatory, the idea that the anti-tobacco crowd makes all these wild claims about tobacco and hidden research and spiking the product. Frankly the companies realized they'd be better off to have government inspectors in the tobacco plants so they can put the lie to all these wild phony claims about what the national tobacco companies do. Much bigger than litigation, as these guys know, is the FDA. The companies came to the table because they wanted a comprehensive resolution of all the issues, and they didn't want to be in a situation where some states won, some states lost, and some states got thrown out. I would simply say though, about litigation, the tobacco companies have never lost a lawsuit except for one in the state of Florida where the state would not let them plead assumption of risk. You remember that. That is that people who assume a knowing risk are responsible for assuming that. Well, in Florida, and the only case that's ever been lost, the court wouldn't let them plead assumption of risk.

So the eighty-five percent of Americans who say that people ought to be responsible for the effects of smoking, well, they couldn't find for the tobacco companies. But be that as it may, this is for the companies. Let's put this behind us. We are willing to pay a price, a price that we don't think we deserve. We think it's a lot more. But they would rather pay the price and put it behind them than be going through this.

I do think, Tom, there are two great lessons here for tort law or for civil litigation or civil damage law. One is, the FDA and others have now said tobacco is addictive. Now I'm not a scientist, but if a scientist says it's addictive, then I'll accept that despite the fact that there are more people who quit smoking than who smoke. Over fifty million people quit smoking, only forty something million still smoke. I'm not a scientist, so if they say it's addictive—but all the rules that make tobacco addictive, make alcohol addictive, make caffeine addictive. And that's the problem. Dickie says, and we dispute, but Dickie says here's this many people who are killed by tobacco. A hundred thousand people were killed in the United States last year by alcohol. The difference is most of them didn't choose to drink the alcohol. They were killed by somebody else who chose to drink the alcohol. Now that is wild. You know Dickie talks about tobacco being unique. What is unique about it is that to the extent that it's a health risk. It is a health risk by those who choose to take the risk.

I would love to see Albert Gore on TV some day with some children and saying, "Don't do drugs," instead of just, "Don't smoke." Binge drinking, drunk driving, narcotics; there are a lot more things here, and we'd better make sure that whatever we do it doesn't create a huge black market not just for cigarettes but for other addictive substances.

MR. MOORE: The only retort I have about this is that most of the people who stopped smoking in America—that fifty million people he's talking about—that's over a long period of time. They die. That's why they stop smoking.

MR. BARBOUR: Wait a second. That was a very cute little thing to say. There are more than fifty million people who are living who have quit smoking. I happen to be one of them. And there are more than fifty million living Americans who stopped smoking.

MR. MOORE: Your numbers are wrong.

MR. SALTER: Well, as one of the fifty million who quit smoking, I can tell you not a damned one of them liked it very much. We're going to end our panel discussion on that and now allow you students to pose some questions. We've got about eleven minutes. Yes, sir? Please stand and identify yourself.

SECOND YEAR LAW STUDENT FROM SAVANNAH, GEORGIA: This is directed to Attorney General Moore. When you filed this lawsuit, you met some domestic resistance from the governor. I saw Governor Fordice on several television stations opposing the lawsuit. I was wondering what type of both professional and personal friendship you felt for the governor.

MR. MOORE: Well, it's probably one of the most unfortunate things for our state in my estimation because, truthfully, I think when history is written, Mississippi will have a very proud moment. You know, it's great for Mississippi to lead the country in something very positive. I would have at least expected my Governor to do the same thing that every other governor in this country did besides him. If they couldn't support their Attorney General, they kept their mouth shut. Our Governor didn't do that. And, frankly, he disagrees, and maybe it's philosophical or whatever it is, but he went to great lengths. He didn't only disagree, he sued me. He and the tobacco companies together sued me. They lost their lawsuit. He lost his 9-0 from the Supreme Court, and they lost theirs 8-1 if I remember correctly. But it's not been a fun time to have the chief executive officer, the governor of the state, sue you. I'm the only attorney general in America who was treated like that by his governor. Frankly, even now that we have the money in the bank, the governor continues to criticize this lawsuit. I wish—frankly, what I wish, and I would do this if he were here today, I would say, "Governor, come on. Let bygones be bygones. Maybe we didn't agree on that issue, but, I mean, let's shake hands." And why won't he say, "That was a pretty good job, Mike." Not in my lifetime.

MR. BARBOUR: Sid, if I can just make a point about that. The companies have been in negotiation with this and forty other attorneys general who represent people. But I think in fairness to the governor, I know a bunch of fine lawyers sitting in this room, and I don't think any of them have ever filed a lawsuit on behalf of the client without the client's permission. In this case, the governor took the position, right or wrong, that Medicaid is under the governor's office and that Medicaid's lawyer, the attorney general, couldn't sue without the client saying to. So, I mean, I don't—again, we've settled this. We're trying to settle this with them, and I'm not being critical of anybody. But I don't think you ought to be unfair to the governor. The governor took the position that the lawyer shouldn't control the lawsuit. The client, Medicaid Commission, should control the lawsuit. In this case, because of Mike being an independently elected official and all that, and because of the timeliness of bringing it, the Supreme Court ruled with him. But don't think if you are a law student that the way it works is the lawyer gets to file a lawsuit when the client doesn't want it.

MR. MOORE: Well, the difference between being a lawyer and being the lawyer, not for the governor, not for the Medicaid business, but for all the people of the state of Mississippi, and being elected independently, the attorney general not only of Mississippi but every state in America, represents the people, and not necessarily the republicans or the democrats or the blacks or whites; they represent the people of this state. When there's friction between whether you should represent what a government official wants to do or what the people of this state who elected you want to do, all the Attorneys General in this country pick the people. What's funny about it is that this issue was brought up in every state in this country by both the tobacco companies and a few other independent parties. They lost every single time just as they lost in Mississippi.

MR. SALTER: Back row, grey sweatshirt.

DANIEL WARE, THIRD YEAR LAW STUDENT: After this settlement, can the tobacco industry be sued any more or is this a one-time deal?

MR. SCRUGGS: The tobacco industry is liable after the settlement assuming it gets enacted by Congress. It's liable to the same extent it has ever been for smokers' claims. It can't be sued again by the State of Mississippi provided they keep making the payments, but a smoker who gets lung cancer can sue their pants off. Smokers cannot get punitive damages. That's the only real change. The individual smoker has unrestricted rights to sue the tobacco industry, but it can't collect punitive damages because in this settlement, there's a $50 billion sum that's set aside for punitive damages. Settle that on a societal basis; that way you don't have certain jurisdictions like Texas and some other places around the country that are sort—you don't have people breaking the bank in one or two jurisdictions at the expense of the whole country. So, other than that, there are no other restrictions on individual smoking.

MR. BARBOUR: And I believe, Dickie, if I'm right, that's for individuals. There can be no class action lawsuits. Only individuals would be able to bring action.

MR. SALTER: In other words, gentlemen, they have made all the money there is to make from this lawsuit. I'm just kidding, it's a joke. Back row, green shirt.

SECOND YEAR LAW STUDENT: This is directed towards the Attorney General. There's been a lot of criticism of what's actually going to happen with the settlement money Mississippi's already gotten. What's the status of that now?

MR. MOORE: That's a real good question. I had a conversation with the Speaker of the House yesterday, and we're still trying to—together with the legislature and myself are—trying to figure out the best thing to do with the national settlement because Mississippi settled obviously early since we had a trial date pending. The $170 million is drawing interest right now at close to a million more a month. So every month that goes by, it increases by another million. The $61 million, it's down there drawing interest too. I hope what we—frankly, in the short term keep that money, invest that money in a trust fund of some sort, maybe where it is or maybe at a higher interest rate for a long period of time. Wait until the national settlement either passes or does not pass next year. I mean, we're looking at maybe May or June, at least August if we get our act together. We may can get that thing passed by May or June of next year. If it doesn't pass, then the legislature can appropriate a planned comprehensive health program for Mississippi children's health, whatever they want to do. But, frankly, when we have that kind of income stream coming into the state, what I would hope they do is spend some time planning for the future on how we might spend that money. Let's just don't go spend it. So keep it in the bank and draw interest. Pretty soon we'll have enough money where we can live off the interest for various programs, and so that's what I hope the legislature would do. Again, when I turn it over to the state treasury, it's kind of up for grabs, and that worries me.

DOW YODER, SECOND YEAR LAW STUDENT: It seems clear to me from listening to both sides of this debate here that in the end, when the President and Senator Lott and Newt Gingrich go behind closed doors and come out with a proposal, both sides will declare victory. The tobacco companies will say, "We're responsible for these bad things and we're going to pay the money." I want someone to comment about the shareholders of these tobacco companies. They're the ones who hold the stock, and just looking at the market right now, the stock prices don't seem to be adversely affected by a twenty-five year, $300 billion settlement. Could somebody explain that?

MR. BARBOUR: Dow, let me just tell you. The tobacco companies are getting a shellacking unheard of in American jurisprudence. They're going to come out of this a highly regulated industry. Phillip Morris today is the largest taxpayer in the United States. It will pay, under today's circumstances, it alone will pay $185 billion in taxes in the next fifty years on top of the billions that they pay today. They're taking a shellacking. Why has the stock market let the stock go up some? Well, the stock has not gone up nearly as fast as the S&P 500 or the Dow Jones. But the stock has gone up some for the reason the companies got in this to start with, because they are trying to pay a huge price for a peaceful marketplace.

All they ask is for adults to be able to choose to smoke, which everybody says they're for. Everybody sitting up here says they're for that. Well, the companies are asking for that, and they're asking if they pay $368 billion or whatever Congress determines it to be for a settlement that they get a settlement. And Dickie said, to his credit, they will get a settlement except that individuals who can prove causation will have the right to come in and sue. The companies have never lost a suit like that ever. So the companies are taking a hell of financial shellacking here. And they are being portrayed by these guys and everybody else that they're some kind of terrible industry, and they want to put that behind them. But don't think that they wanted to do this. They just made the decision that in the end, their stockholders would be better off by paying for peace than for letting it continue to be shot at in regulatory, shot at in litigation, and shot at in legislation.

MR. MASON: I just want to comment that one might also remember that the portions of evil are not going to pay for that. The consumers are going to pay.

MR. BARBOUR: As always.

MR. MASON: That makes the stock price want to stay even.

MR. BARBOUR: That's right.

MR. SALTER: Well, when you talk about evil, you always have to go back to Charles Nelson's great quote about what follows hearts and minds. I think that may be where we are at this thing. We can talk about this for several hours, and it's really a fascinating panel that they've gathered, but it's time for us to wrap this up. We are going to close with a two-minute closing statement from each of the panelists. We'll begin with Mr. Barbour.

MR. BARBOUR: Thank you for inviting us. I think more education and more sunshine on this is probably good for everybody. As you can see, while Dickie and Mike and I have some very strong disagreements about some of the underlying facts and premises, the fact is that the Attorneys General have led the forging of a proposed comprehensive resolution that the tobacco companies agreed to, even though there's a lot that we don't like. Some of it we don't agree with. We have said we'll support it, and we will support it. We want to aggressively attack youth smoking. We want to do it because it's right. We want to do it because we do not want it to be used against us anymore. But we want, in paying an unprecedented amount for settlement, in voluntarily agreeing, consenting to give up constitutional rights that Congress cannot take from the company, that we're willing to give those up as part of a comprehensive settlement that protects the rights of adults who use traditional tobacco products that allows those adults to obtain those products legally in a peaceful marketplace. And that once we pay for the settlement that we get a settlement. What we don't want is to pay for a settlement and then not get one. So we come to the table very frankly with a small agenda. We're willing to be heavily regulated. In some ways it may help our industry's reputation to be heavily regulated, and we agreed to the public health people's demands. I am proud of the fact and was not surprised because I'd been told this when I was hired that the companies went in, not only prepared, but eager to agree to do everything any responsible group proposed to attack youth smoking. And even the companies' biggest enemies admit that the companies have done so.

MR. SALTER: Mr. Scruggs.

MR. SCRUGGS: Dean Davis, Sid Salter, I want to thank you for inviting me to be here today. I think this has been a very, very energetic debate and discussion with some of the most important social and economic issues in the latter half of the 20th century. It is rare to have an opportunity as a lawyer to be involved in litigation that makes as much difference to the world as this tobacco litigation has made. None of us in our wildest dreams four years ago would have envisioned a national comprehensive settlement or resolution of the most pressing health problem in American history. We are on the verge now of transforming American health for the twenty-first century and for future generations. We have a real opportunity to marginalize a very, very dangerous practice. I'm even prouder to be part of a group of four or five lawyers who graduated from this law school. You already met Mike Lewis; he raised his hand. Mike Moore, my law partner, Steve, and I were all in the same class here. We graduated in December of 1976, so we've been practicing law a little over twenty years. But we're very proud of the fact that this is a homegrown Mississippi idea that has now become a national move. So, Tom Mason, I want to thank you for what you taught me out here. You taught me a lot.

MR. MASON: I would have never figured out that he was going to go this far with that.

MR. SCRUGGS: So thank you very much.

MR. SALTER: Professor Mason.

MR. MASON: I just can't—from my viewpoint the fact of the matter is Haley and I crossed paths as he left in 1973, and I was coming here. But I do remember both Mikes and Dick. They were a great group, and one could tell that good things were going to come out of them. My part of this, I suppose, is being a tort professor. I'll say I'm really sorry that they settled this thing because they had some completely unique legal theories. I was anxious for those legal theories to get to our Mississippi Supreme Court because they were either going to make some law or they were going to go away with nothing in their pockets. I wish I could have seen that law either being made or at least seen the court have an opportunity to deal with them.

MR. SALTER: Mr. Moore.

MR. MOORE: Well, I add to what Dick says. Thanks, Sid, for being here with us, indeed. Thank you, guys, for putting this on. We think it's a pretty significant thing for Ole Miss Law School. It's also been fun for me. I just have to tell you in my closing statement, this is the most fun I've ever had in my life. It's also been the most fascinating and challenging venture that a lawyer could ever be involved in. If you'll think from where we came and where we are now, I mean, everybody on this panel—and what makes me shake a little bit is when my law professor says he didn't think we had a snowball's chance. But, frankly, we think when the story is written about what has been achieved, I think what you're going to see is several messages. One is going to be a message about a state that a lot of people have mixed messages about, but a state that you and I are obviously very, very proud of.

I hope when history is written that this is one of the proudest moments for Mississippians and one of the proudest moments for this law school. It's been a learning adventure for Dick and me. Although people think we knew each other very well, we didn't. But after spending almost every day of the last three and a half years with each other, we formed a very strong friendship and partnership. It's taken the skills of lawyers like Dick and Mike and so many others who never gave up. If I can give you any advice in your law career, if you're going to take on a challenge, no matter what the case is, whether it's a hundred bucks or a hundred billion bucks, you ought to have the determination to never give up as long as you think you're right. And that will be the lesson in determination because these guys on the other side of the table, they keep telling us this and we are reminded of it. They never paid a penny to anybody. They always beat them down into the ground with their money and their resources. In this particular case, a couple of old country lawyers from Mississippi and a few other folks have put forth a national deal worth $368.5 billion. This may be one of the proudest moments in Mississippi history. I'm just glad I was part of it. Thank you.

MR. SALTER: Ladies and gentlemen, they messed up and gave me two minutes of closing statements, and I'm going to take it. I have had more fun, Mike, but certainly never in a room full of lawyers. But it has been a great pleasure to be here today, and to you law students, I would say this. Look around the room. Look at the person sitting beside you. You live in a very unique state. Somebody sitting by you might grow up to be the Attorney General, may grow up to lead one or two major parties, may be the richest lawyer you know. But you live in a special state. I think what makes it special is the fact that you can have people from divergent backgrounds, of divergent philosophies, representing divergent interests who can come and do their business and depart and still be friends. That's why I choose to make this home. I've known two of these guys a lot longer than any of us care to admit. I know where they came from, and I know how hard it was for them to get here. Look around this room. Some of you will achieve those things in your career, and hell, if you want, you can always write a newspaper column.

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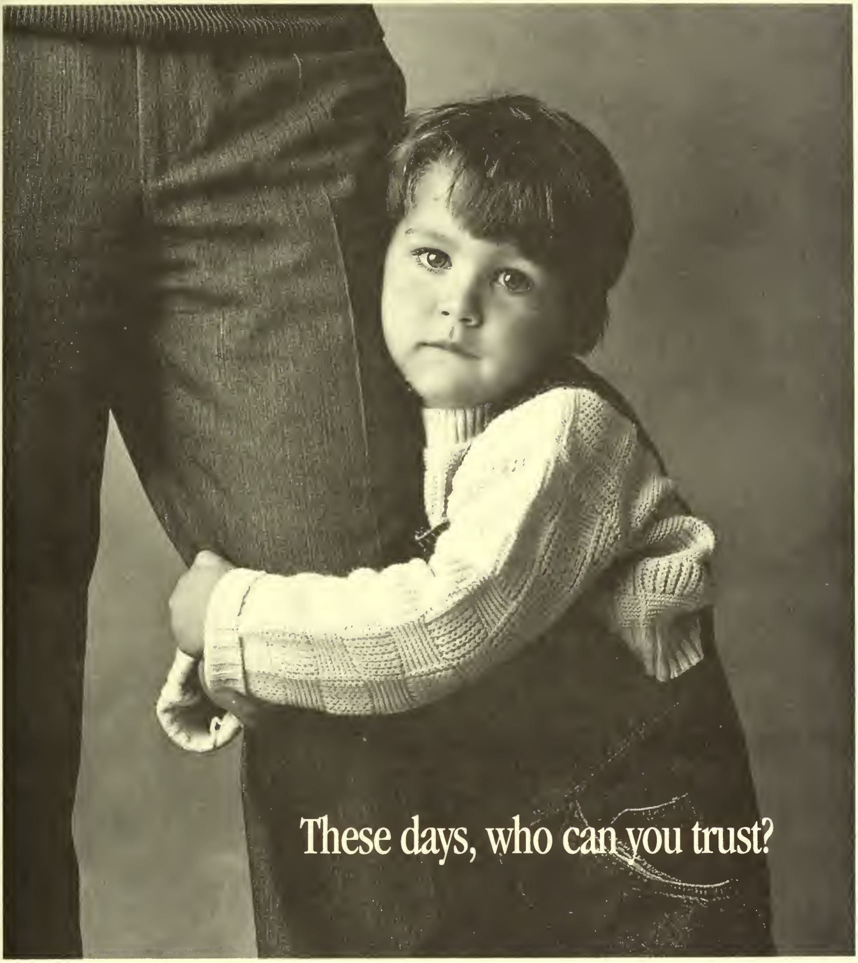
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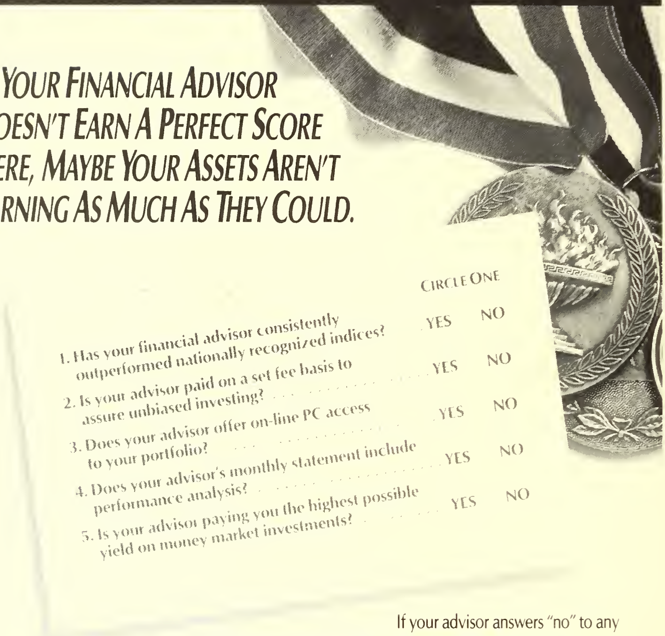

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